ECONOMISTS ON PRIVATE INCENTIVES, ECONOMIC MODELS, AND THE ADMINISTRATIVE STATE: THE CLASH BETWEEN HAPPINESS AND THE SO-CALLED PUBLIC GOOD

By Sandra J. Peart*

Abstract: *This essay examines the administrative state as a ubiquitous phenomenon that results in part from the mismatch of incentives. Using two dramatic episodes in the history of economics, the essay considers two types of mismatch. It then examines how economists increasingly endorsed the "general good" as a unitary goal for society, even at the expense of private hopes and desires. More than this, their procedures and models gave them warrant to design mechanisms and advocate for legislation and regulations to "fix" the supposedly suboptimal choices of individuals in service to the overarching goal. The rise of New Welfare Economics dealt an additional blow to the sovereignty of individual motivations, notwithstanding that Hayek and Buchanan warned that this engineering approach allowed social goals to override individual preferences. Throughout, the argument is that it is important to recognize that people within or advising the administrative state are influenced by the same sorts of (private) motivations as actors throughout the economy.*

KEY WORDS: James Buchanan, eugenics, goals, J. S. Mill, New Welfare Economics, private incentives, public good, Lionel Robbins, Soviet growth, Virginia School

1. Introduction

This essay examines the administrative state as a ubiquitous phenomenon that results in part from the mismatch of incentives. Using two dramatic episodes in the history of economics, the essay considers two types of mismatch. In the first instance, private incentives and goals of the governed were overridden in service to a supposed overarching public goal, the "welfare" of society, writ large. The case study that perhaps best illustrates this mismatch is eugenics, when the search for the "betterment" of the human race overwhelmed the private goals of individuals. Economists were not the only public intellectuals who entered into debates about eugenic policy, but their views on social welfare, as opposed to the happiness of individuals, offered a significant intellectual underpinning for eugenic policies. Second, in their evaluations of Soviet growth rates, many economists presented an institution-free analysis in which they assumed that the private incentives of those who implement policy fully aligned with the stated public goal of economic growth. It later became clear that, in fact, those who implemented the goal of economic growth were also motivated to achieve their private goals of economic betterment.

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The essay thus relies on Charles Wolf's insight regarding "internalities": "the private goals that apply within nonmarket organizations to guide, regulate, and evaluate the performance of agencies and their personnel."[1] Peter Schuck suggests that internalities are a key explanation for government failures. In what follows, I focus on how economists over time have dealt with the issue of private and public incentives, and demonstrate that, after the mid-nineteenth century, they increasingly endorsed some sort of public good as a unitary goal for society, even at the expense of private hopes and desires. More than this, their procedures and models increasingly gave them warrant to design mechanisms and advocate for legislation and regulations to "fix" the supposedly suboptimal choices of individuals in service to the overarching goal. Accordingly, this examination opens the way for a consideration of how to proceed in the face of mismatched private and public incentives. Recognizing the existence of private incentives that do not fully align with those who are subjected to interventions is a first step in questioning the incentives of those within the administrative state who advocate for interventions or interpret and implement legislative policy.

It is important to recognize that the focus in what follows is on the motivations and incentives of those within the administrative state. Actors within the administrative state are subject to the same sorts of motivations (no more, and no less) as actors throughout the rest of the economy. They are subject to the desire for power and influence and may allow these private motivations to override agreed-upon public norms or legislative intentions.[2]

After a brief sketch of what went so badly wrong in the cases of eugenics and Soviet growth analysis, the essay examines how economists increasingly "turned away" from the presumption that individual happiness mattered and the appropriate ways to pursue happiness, through democratic discussion.[3] Late in the nineteenth century, they eschewed that presumption, offering instead an expert-determined notion of "general good" or "social improvement" as a single goal for society.[4] More than this, they

[1] Peter G. Schuck, *Why Government Fails So Often And How It Can Do Better* (Princeton, NJ: Princeton University Press, 2015), 150.

[2] My approach complements studies that examine the advantages and disadvantages associated with the administrative state or challenges to it. See Ronald J. Pestritto, "Constitutional and Legal Challenges in the Administrative State," this volume, and Anne Barnhill and Brian Hutler, "SNAP Exclusions and the Role of Citizen Participation in Policy-Making," this volume.

[3] The phrase "turn away" is used by Lawrence White, *The Clash of Economic Ideas: The Great Policy Debates and Experiments of the Last Hundred Years* (Cambridge: Cambridge University Press, 2012), 12–31. The most dramatic example of reform achieved through democratic discussion was the abolition of slavery. J. S. Mill was involved in many other significant reforms, repeal of the Corn Laws, extension of the franchise and property rights to women, the Governor Eyre controversy, and the question of birth control. See Sandra J. Peart, "Editor's Introduction," *Hayek on Mill: The Mill-Taylor Friendship and Related Writings*, Volume XVI of *The Collected Works of F. A. Hayek*, ed. Bruce Caldwell (Chicago: Chicago University Press, 2015), xix–l.

[4] Joseph Postell, "The Ambiguity of Expertise in the Administrative State," this volume, also emphasizes the role of trained, so-called experts who administer policy with a goal of

put themselves forward as being best able to prescribe how to achieve the "general good." As such, a door opened for the "general good" to override individual happiness. Section III examines how the economic analysis of William Stanley Jevons through Alfred Marshall exemplified this turn.

The rise of New Welfare Economics dealt an additional and key blow to the sovereignty of individual motivations and the achievement of reform via democratic discussion. Section IV examines how, with a few exceptions, economists came to postulate a unitary social goal, and then presumed they could provide advice on how to obtain it. While much ink was spilt over whether and how to combine individual preferences, for example, whether interpersonal utility comparisons were warranted, the outcome was that New Welfare Economics, as embodied in Kaldor-Hicks efficiency, collapsed individual goals into one, exogenously determined social goal.

While Kaldor-Hicks became the accepted way that economists at mid- and late-century dealt with policy issues, two strands of opposition emerged. Section V briefly describes these challenges. First, F. A. Hayek argued that there is no way to determine and then achieve unitary social goals. That argument and his opposition to central planning sparked a long and vigorous debate over whether planning was feasible, but the central point of whether a unitary goal makes any sense was relatively unappreciated by the profession. Independently, James Buchanan developed another, also underappreciated approach to Kaldor-Hicks. Indeed, a key intellectual pillar of the early Virginia School was the attempt to provide an alternative to the then widely accepted Kaldor-Hick approach to economics. In this view, the problem with New Welfare Economics as embodied in Kaldor-Hicks is that it collapsed individual goals into one, exogenously determined social goal.[5] Buchanan argued the engineering approach to economics and economic policy neglected dangers associated with misspecifying social goals or positing that social goals override individual goals. Section IV lays out what became the orthodox position and investigates challenges to New Welfare Economics. In today's vernacular, New Welfare Economics is a top-down means of obtaining reform, while Buchanan (and Mill and others before him) provides a bottom-up conception of reform.

II. Mismatches of Private and Public Goals

The foregoing outlined two possible reasons for the failure of the administrative state: public goals ignore the goals of the governed or of those who

efficiency. As we will see in Section II.B, I would add to this that the stated goal of efficiency may obscure the private goals of the administrators who enriched themselves while creating food and other shortages in the former Soviet Union.

[5] James Buchanan, "Positive Economics, Welfare Economics, and Political Economy," *Journal of Law and Economics* 2 (1959): 124–38.

implement policies. In this section, I examine the case of eugenics as an example of the former and the analysis of Soviet growth as an example of the latter.

A. Eugenics

The rise of eugenic policy measures represents one of the most egregious instances of the administrative state gone wrong.[6] As Charles Darwin and the Law of Natural Selection appeared in biology, those who studied human arrangements, anthropologists, sociologists, and political economists, used biological science to speculate about how best to obtain human "progress." Economists became part of the debate when they advocated for aggregate "welfare" as opposed to human happiness. As the episode unfolded, the idea that, as long as their pursuits do not harm others, people should be allowed to pursue happiness fell somewhere behind a goal of so-called human progress. While some economists were wary of eugenic policies early on, they became convinced by "experts" on the subject matter that education alone was insufficient to obtain lasting progress.

In 1864, A. R. Wallace, who independently from Darwin discovered the Law of Natural Selection, questioned whether the principle of natural selection applied to humans. In a paper first presented at the Anthropological Society, then presided over by James Hunt[7] and subsequently widely reprinted, Wallace asserted that natural selection did *not* apply to humans because humans sympathize with one another and they do not let disabled, sick, or old people perish. Wallace emphasized that what was then referred to as sympathy[8] created a sphere for individuals, subject to the consent of others, to pursue happiness.[9]

Wallace's demonstration that natural selection is checked by human sympathy marks the beginning of the eugenics movement. In opposition to Wallace, the co-founder (with Francis Galton) of eugenics, W. R. Greg,[10]

[6] For an account of these measures in the American context, see Tiffany Miller, "Richard T. Ely, the German Historical School of Economics, and the 'Socio-Teleological' Aspiration of the New Deal Planners," this volume.

[7] Hunt was president of the Anthropological Society and the owner and editor of the *Anthropological Review.* Arthur Keith writes: "[Hunt] has the fire and enthusiasm of an evangelist and the methods of a popular political propagandist." Arthur Keith, "Presidential Address. How Can the Institute Best Serve the Needs of Anthropology," *Journal of the Royal Anthropological Institute of Great Britain and Ireland* 47 (1917): 19. See Sandra J. Peart and David M. Levy, *The 'Vanity of the Philosopher': From Equality to Hierarchy in Post-Classical Economics* (Ann Arbor: University of Michigan Press, 2005), 67–74.

[8] A. R. Wallace, "The Origin of Human Races and the Antiquity of Man Deduced from the Theory of 'Natural Selection'," *Journal of the Anthropological Society of London* 2 (1864): clviii–clxxxvii. Today, sympathy has resurfaced as a concept of significance. See *Sympathy: A History,* Eric Schliesser, ed. (Oxford: Oxford University Press, 2015). For our purposes, it suffices to consider sympathy as the means by which individuals connect to the group.

[9] Peart and Levy, *The Vanity of the Philosopher.*

[10] Greg was a classmate of Darwin and, in his time, an influential writer on political economy. He argued, contra J. S. Mill, that the Irish were naturally inferior. He was also long

responded that since sympathy blocked the "salutary" effects of natural selection, it should therefore be suppressed:

> My thesis is this: that the indisputable effect of the state of social progress and culture we have reached, of our high civilization in its present stage and actual form, is to counteract and suspend the operation of that righteous and salutary law of "natural selection" in virtue of which the best specimens of the race—the strongest, the finest, the worthiest – are those which survive … and propagate an ever improving and perfecting type of humanity.[11]

Much of the eugenics rhetoric attempted to show that the "unfit" were undeserving of sympathy. As an example, Greg described the Irish, who in his view were subhuman relative to their human counterpart, the Scots: "careless, squalid, unaspiring Irishman, fed on potatoes, living in a pig-stye, doting on a superstition, multiply like rabbits or ephemera."[12] Late in his life, when Wallace remembered Galton's proposals for positive eugenics, such as subsidizing the marriages of college professors, he was much more critical of Galton's disciples who proposed "negative eugenics"—policies to reduce births among the "unfit."[13]

Also at issue in the debate over human happiness versus Darwin's "general good"[14] was whether it was advisable to have unrestricted access to information on how to limit births. Some analysts, including Darwin, feared that as contraceptive information became widely available at low cost, the lower classes would increasingly take advantage of it and reduce family size. This was regarded as a problem because it would suspend the "salutary" effects of the law of natural selection. Others, like Annie Besant, Charles Bradlaugh, and J. S. Mill, advocated wide access in order to mitigate the misery associated with unwanted births and extreme poverty. For them, there was nothing "natural" about applying the law of natural selection to humans.

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associated with *The Economist* whose role in applying biological models to political economy has been largely overlooked.

[11] W. R. Greg, *Enigmas of Life* (Boston: James R. Osgood, 1875), 119.

[12] W. R. Greg, "On the Failure of Natural Selection in the Case of Man," *Fraser's Magazine for Town and Country* 78 (1868): 360.

[13] A. R. Wallace, *Social Environment and Moral Progress* (London: Cassell and Company, 1913), 127. Later in the century, the economist F. Y. Edgeworth would attempt to work this out using a utilitarian calculus. Those whose lifetime happiness was negative, because of an inferior capacity for pleasure, were net drains on social welfare and might therefore be removed from society. See F. Y. Edgeworth, *Mathematical Psychics* (London: C. Kegan Paul and Co., 1881) and Peart and Levy, *Vanity of the Philosopher*, 226–30.

[14] See Charles Darwin, *The Descent of Man, or Selection in Relation to Sex* (London: John Murray, 1871), 125 and, for additional detail and discussion, Peart and Levy, *Vanity of the Philosopher*, 222ff. In addition to the "general good" wording, Darwin used the phrase "welfare of mankind" (ibid., 643). Peart and Levy, ibid., discuss the contrast with J. S. Mill's (and Adam Smith's) notion of the happiness of individuals.

The 1877 Trial of Bradlaugh and Besant[15] for the "crime" of republishing a forty-year-old text on birth control—Charles Knowlton's *Fruits of Philosophy* —focused on the question of human happiness versus so-called human betterment. The substantial question debated at the Trial concerned the means by which Bradlaugh and Besant were disseminating contraceptive information. The question for the jury was this. Stipulating that contraceptive information, when presented in medical books at 30 shillings or sold to the wealthy patients of physicians at 2 shillings 6 pence, was legal, did publishing this information in a 6 pence pamphlet constitute an obscenity?[16] Previously, the high price and dissemination of the information using physicians as intermediaries served as control mechanisms. Debate at the trial focused on whether birth-control material constituted something that ordinary people could read and understand on their own or whether it should be dispensed to those deemed worthy by a physician?

Besant defended *her* position against that of Darwin by appeal to Mill's *Political Economy.*[17] She constructed her case to show that access to contraceptive information and the consequent prevention of misery was as "natural" as the so-called natural selection accompanied by premature death. She placed Malthus and J. S. Mill on the side of human happiness and preventative checks enabled by foresight and full information, and Darwin on the side of unthinking natural selection and human misery.

The key issue was clear as a new generation of scientists developed policy recommendations in the wake of these debates: Was it best to let ordinary people choose to marry and have children or might the pursuit of some exogenously determined goal, the "general good," justify overriding those choices? For some, including scientists who advised policy makers on marriage and family formation decisions, the desires of actual human beings were to be overpowered by forced sterilization. Here, surely, policy makers overstepped their authority in a particularly egregious way.

B. Soviet versus U.S. growth in economics textbooks

A second type of failure in policy analysis is illustrated by U.S. economists' treatment of Soviet growth after 1960.[18] In this instance, American economics textbooks reporting on Soviet and U.S. growth from 1960–1980 seem to have neglected the incentives of those who implemented central planning.

[15] David M. Levy and Sandra J. Peart have written extensively about the jury as an instance of democratic decision-making. See *Escape from Democracy: The Role of Experts and the Public in Economic Policy* (New York: Cambridge University Press, 2016), 211–31.

[16] *Queen v. Charles Bradlaugh and Annie Besant. June 18, 1877* (London: Freethought Publishing, 1878), 139, 147.

[17] J. S. Mill, *Principles of Political Economy, The Collected Works of John Stuart Mill*, Volumes 2–3, ed. John Robson (Toronto: University of Toronto Press, 1965).

[18] David M. Levy and Sandra J. Peart systematically study the treatment of Soviet growth in American textbooks from 1960 through 1980. This section draws upon that research. See "Soviet Growth and American Textbooks: An Endogenous Past," *Journal of Economic Behavior and Organization* 78 (2011): 110–25.

American economists instead supposed that Soviet planners would efficiently implement the stated goal of economic growth. They assumed zero waste or impoverishment of Soviet citizens and no bribes or other means of benefiting on the part of those who implemented planning. Textbook writers failed to consider the possibility that the incentives of those in the administrative state do not always align with the goal(s) of the State.

Samuelson's textbook contains perhaps the most famous account of Soviet growth.[19] In it, he pioneered the use of the production possibility frontier (PPF) as the means by which to compare different economies. The PPF brought elegance by abstraction and collapsed each society into a two-dimension production possibility set. Of course, applying the PPF to Soviet and American growth assumed that institutional differences between the two economies were irrelevant. The assumption that economic analysis applied across wide institutional differences meant the country that invested more as a share of GDP would also grow more quickly.

In 1961, Samuelson created a graph to forecast Soviet and American growth trajectories. Using different assumptions about Soviet and American growth rates, he projected when the Soviet economy would overtake the U.S. economy. The first projection (a max-min overtaking point) was based on the maximum Soviet growth assumption and the minimum American growth assumption. The second projection was more cautious about when the overtaking will occur. It used the maximum Soviet growth assumption and the maximum American growth assumption. The graph thus presents a range of uncertainty attached to the growth estimates.

Of course, it is well known that the Soviet economy was growing less quickly than once thought. Instead, disequilibrating prices and pervasive shortages were the result of the planners' pursuit of self-interest as opposed to the public goal of economic growth.[20] Far less appreciated, however, is that after two decades of non-confirming evidence, textbook predictions remained unchanged. Authors who made such claims continued to assume that planners would selflessly serve the interest of the public. Indeed, the trust in the future and skepticism about the past formed the basis of a standard Soviet-era joke: "Under Communism, the Poles are fond of saying, only the future is certain; the past is always changing."[21] This is why David Levy and I have called our study of textbook treatment of Soviet growth "the endogenous past" project.

Why were Samuelson and other authors of important textbooks of the 1960s and 1970s so confident about Soviet economic growth that they

[19] See Paul A. Samuelson and Anthony Scott, *Economics: An Introductory Analysis* (Toronto: McGraw Hill, 1966–1971).

[20] See David M. Levy, "The Bias in Centrally Planned Prices," *Public Choice* 67 (1990): 213–36, and A. Shleifer and R. Vishny, "Pervasive Shortages under Socialism," *Rand Journal of Economics* 23 (1992): 237–46.

[21] G. Warren Nutter, *The Strange World of Ivan Ivanov* (New York and Cleveland: World Publishing, 1969).

repeatedly blamed evidence of model failure on events outside the model's control? First, those who were overly optimistic, whose textbook predictions were repeatedly falsified over time, adopted as a starting point the presumption, noted above, that the Soviet and the U.S. economies were essentially the same despite institutional differences.[22] Second, they failed to appreciate the mismatch of incentives between the self-interested party officials who supposedly implemented planning edicts and the stated public goal of central planning. In short, many economists at the time apparently ignored evidence that would have been obvious to someone who recognized that the private incentives of the planners failed fully to align with the stated public goal of economic growth.

III. The Turn Away from Private Goals

The foregoing suggests two ways the administrative state may fail: when there is a mismatch between the hopes and desires of individuals and a public goal, and when there is a mismatch between the private goals of those who work for the state and the public goal. The question for economists who study incentives, is how they would fail to note such significant mismatches. One answer to this question is the late nineteenth century turn away from private goals. Late in the nineteenth century, economists increasingly discounted the Smithian presupposition that people are able to make reasonably good choices. Beginning with William Stanley Jevons and Alfred Marshall, and continuing with A. C. Pigou, Irving Fisher, and others, economists questioned the ability of their subjects to decide correctly, and they endorsed policy recommendations to intervene with or override choices by individuals. As economists came to question the so-called rationality of, especially, the laboring classes, they also came to regard themselves as better at seeing what ordinary people *should* choose. When they observed that people did not do these things, they saw this as proof that people were irrational. Then they turned away, as Terence Hutchison observed, from laissez-faire.[23]

As noted, this turn is evident in the writings of William Stanley Jevons and Alfred Marshall. Indeed, Marshall and Jevons did much to promote the idea that ordinary people, who are not in formal equilibrium, are irrational. They described such people as "myopic," and shortly after, A. C. Pigou wrote about their "faulty telescopic faculty" thereby suggesting that they were unable adequately to foresee the future.[24]

[22] It is important to note, however, that there were some exceptions at the time. Warren Nutter and W. W. Rostow, who did not share an ideological affinity, held that the institutional frameworks in the Soviet Union and the United States were so different as to make such comparisons unwarranted.

[23] T. W. Hutchison, *On Revolutions and Progress in Economic Knowledge* (Cambridge: Cambridge University Press, 1978), 95–120.

[24] See, for example, William Stanley Jevons, "Inaugural Address as President of the Manchester Statistical Society on the work of the Society in Connection with the Questions of the

Marshall, like Jevons, regarded the economic theorist as a superior when it comes to specifying optimal decisions, with the added ability to design mechanisms to bring people into equilibrium. Relying on a presumption in favor of "prudence," he described variations in the rate of "impatience" among consumers, and surmised that poor consumers are relatively impatient. The "prudent" consumer "endeavours to distribute his means between all their several uses, present and future in such a way that they will have in each the same marginal utility." This would imply saving for old age. Like Jevons, however, Marshall maintained that (especially poor) consumers overly discount the future, that "human nature is so constituted that in estimating the present value of a future benefit most people generally make a second deduction from its future value, in the form of what we may call a discount, that increases with the period for which the benefit is deferred." He attributed this time preference to a lack of patience and self-control: "one will reckon a distant benefit at nearly the same value which it would have for him if it were present; while another who has less power of realizing the future, less patience and self-control, will care comparatively little for any benefit that is not near at hand."[25]

Marshall suggested that impatience also interfered with prudent consumption habits, the preferred tendency "to buy things which will be a lasting source of pleasure rather than those that will give a stronger but more transient enjoyment; to buy a new coat rather than to indulge in a drinking bout, or to choose simple furniture that will wear well rather than showy furniture that will soon fall to pieces."[26]

For early neoclassical economists, importantly, some groups were particularly susceptible to this flaw, and sometimes their accounts were racialized, identifying the Irish as particularly impatient.[27] In most accounts the laboring classes are said to be susceptible to high rates of time preference and, consequently, low (suboptimal) rates of savings and investment in intergenerational improvements in human capital. Early neoclassical accounts did not stop here but continued to consider policy implications. The theorists who knew better assumed the authority to ensure that inferiors optimize, that they buy Marshall's proper furniture. In the words of Sydney Webb, the superiors who make and implement policy must "interfere, interfere, interfere."[28]

Day," "Amusements of the People," and "Married Women in Factories," in *Methods of Social Reform* (New York: Augustus M. Kelly, 1965), 180–93, 1–27, and 156–79, as well as *Theory of Political Economy*, 4th ed. (London: Macmillan, 1911). Sandra J. Peart provides additional detail on the material in this and the following two paragraphs, including source material for the passages quoted above. See "Irrationality and Intertemporal Choice in Early Neoclassical Thought," *Canadian Journal of Economics* 33 (2000): 175–88.

[25] Alfred Marshall, *Principles of Political Economy*, 8th ed. (London: Macmillan, 1930), 120.

[26] Ibid., 120.

[27] For more detail, see Peart and Levy, *Vanity of the Philosopher*.

[28] Sydney Webb, "Eugenics and the Poor Law: The Minority Report," *The Eugenics Review* 2, no. 3 (1910): 241. As noted above, at its extreme, such thinking led some late nineteenth- and early twentieth-century economists to endorse eugenic policies. At issue was whether the

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Thus, economists in the late nineteenth and early twentieth century solved the formal optimization problem and then invoked "irrationality" as the explanation for observed deviations from the optimum.[29] They then designed policy, using what we think of today as nudges, to move people to the so-called optimal rates. While, as Francis Bator states,[30] economists removed institutions from their models of consumer choice, at the same time they proposed policies to "fix" choices that did not conform to the apparently institution-free equilibrium analysis. As they increasingly became advisors to policy makers and part of the administrative state, they also had so-called scientific, theoretical warrant to discount the revealed choices of those in the polity.

All of this is to say that, with a few exceptions discussed in Sections IV and V below, mainstream economists writing late in the nineteenth century regarded apparently suboptimal choices as justifications for intervention. One dramatic example is evident in the following passage from Edgeworth. In it, Edgeworth wrote about the danger inherent in Mill's view that people were equally able to make choices, "the authority of Mill, conveying an impression of what other Benthamites have taught openly, that all men, if not equal, are at least *equipotential*, in virtue of equal educatability" a position that would "probably result in the ruin of the race" because it failed to take into account "[*d*]*ifference of quality*" among men. In Edgeworth's view, Mill's position was unscientific, a "pre-Darwinian prejudice."[31] Indeed, Edgeworth is a key transition figure in this context. While the trading partners in his analysis are necessarily equals—a feature of the model—in the later portion of *Mathematical Psychics*, where Edgeworth develops his social welfare function, he allowed for systematic differences in the capacity for enjoyment, with the result that some people accrue negative total utility over their lifespan. Here, we see the danger of the administrative state: the economist qua expert imposes the model on individual choice such that a person's very existence reduces social welfare, and they should thus be banished from the polity!

IV. New Welfare Economics

While early neoclassical economists played up their ability to use regulations and legislation to induce good choices, especially among the

tendency to make poor choices was inherited, or whether education might correct one generation at a time. Most economists favored education, but some also came to endorse forced sterilization in an apparent attempt to "correct" for purportedly inherited flaws.

[29] Tiffany Miller, "Richard T. Ely," this volume, examines the paternalistic policies that flowed from the pronouncements of irrationality. For a definitive challenge to the idea that such preferences are irrational, see Mario J. Rizzo and Glen Whitman, *Escaping Paternalism: Rationality, Behavioral Economics and Public Policy* (Cambridge: Cambridge University Press, 2020).

[30] Peter J. Boettke, *F. A. Hayek: Economics, Political Economy and Social Philosophy* (London: Palgrave Macmillan, 2018), 161.

[31] Edgeworth, *Mathematical Psychics*, 132.

laboring classes, the hubris of economists took another leap early in the twentieth century. In the decades that followed the emergence of neoclassical economics, orthodox economics unified around an approach to the economic problem described in Lionel Robbins's famous work, *The Nature and Significance of Economic Science* (1932), how to best attain goals in the face of scarcity. Robbins was satisfied with economic models of individual choice,[32] but he denied that a large part of economics, specifically that associated with policy recommendations, was scientific. Most famously, while it was proper to suppose that the marginal utility of a good fell as the quantity consumed increased, there was no scientific procedure to analyze economic policies that inevitably involved utility comparisons across persons. Some people win from a policy change, while others lose, and Robbins held that there was no scientific way to calculate a net gain or loss. Instead, such judgments were matters of ethics or convention. Robbins himself was comfortable with a political economy in which social conventions provide the calculus, but he insisted that such conventions were unscientific.

Robbins's *Nature and Significance* rocked the economics profession because it undercut the status of economists as policy advisors or participants in the administrative state, making the case that economists had no scientific warrant on which to base their advice. For Robbins, this was not such a problem—one might invoke ethics as the means to obtain goals and then proceed. What if it were possible to re-elevate policy advice to the status of science? This was the challenge that New Welfare Economics, shortly to be developed, seemed to answer. In their attempt to reconstruct the scientific basis for policy analysis, New Welfare Economists allowed, first, that interpersonal comparisons might be rendered unnecessary—as when output increased as a result of a policy intervention and all people might possibly be made better, or no worse off, through a series of compensations from winners to losers. Nicholas Kaldor developed this reasoning as the formative statement of New Welfare Economics and, in so doing, he apparently enabled the economist to offer scientifically based economic policy advice notwithstanding Robbins's objections. Kaldor appealed to the possibility of compensating those who lose from a policy shift:

> In all cases, therefore, where a certain policy leads to an increase in physical productivity, and thus of aggregate real income, the economist's case for the policy is quite unaffected by the question of the comparability of individual satisfactions; since in all such cases it is

[32] Lionel Robbins, *An Essay on the Nature and Significance of Economic Science*, rev. ed. (London: Macmillan and Co., 1932). Even this was, for Robbins, something of a reach as there was no reason to believe economists possess complete understanding of religious views, customs, or other factors that influence demand. The following two sections draw on David M. Levy and Sandra J. Peart, *Escape from Democracy*, 68–88.

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> *possible* to make everybody better off than before, or at any rate to make some people better off without making anybody worse off. There is no need for the economist to prove—as indeed he never could prove—that as a result of the adoption of a certain measure nobody in the community is going to suffer. In order to establish his case, it is quite sufficient for him to show that even if all those who suffer as a result are fully compensated for their loss, the rest of the community will still be better off than before. Whether the landlords, in the free-trade case, should in fact be given compensation or not, is a political question on which the economist, qua economist, could hardly pronounce an opinion. The important fact is that, in the argument in favour of free trade, the fate of the landlords is wholly irrelevant: since the benefits of free trade are by no means destroyed even if the landlords are fully reimbursed for their losses.[33]

Assuming that people are concerned only with physical things and that their goals are fixed, New Welfare Economists focused on policies to increase physical output. If there were more things to go around after the policy change, and people's goals remained unchanged, then it was possible at least in principle to redistribute and ensure that no one suffered a reduction in physical output.[34] Whether the redistribution actually occurred became a matter of debate. The fixed preference response to Robbins assumed that physical units were all that mattered. To use Kaldor's example, suppose that removing a tariff on corn imports increases the real income of the community by allowing more corn into the market. If the case for free trade depends upon only the quantity of corn, the assumption is that no one in the community cares about how the policy is implemented, for example, whether the tariff is removed by vote or at the point of a gun. The implicit assumption underlying the argument was that people have no preference for process but care only about product.

Thus, the new approach enabled economists plausibly to "discover" instances in which individuals "fail" to pursue their goals—cases in which output is not maximized—and to propose some mechanism to correct this failure. New Welfare Economists took a step beyond the position of the economists examined in Section III. Their approach attained high status in the 1940's through the research of the Cowles Commission, then housed at the University of Chicago. Its most famous proponents, Tjalling C. Koopmans and Kenneth Arrow, both of Cowles, provided the technical framework required by the claims of fixed preferences.

[33] Nicholas Kaldor, "Welfare Propositions of Economics and Interpersonal Comparisons of Utility," *Economic Journal* 49 (1939): 549–52. Emphasis in the original. Unlike Buchanan, Kaldor takes no account of process in his analysis: if physical output increases via theft, it is the same as if it increases via a lower tariff. For Buchanan's contrasting view, see Section V.B.

[34] See J. R. Hicks, "The Foundations of Welfare Economics," *The Economic Journal* 49 (1939): 696–712.

V. Challenging New Welfare Economics

A. Unitary goals[35]

F. A. Hayek mounted what is perhaps the most well known challenge to New Welfare Economics. Unfortunately, in his critique of the unitary goal, Hayek did not address New Welfare Economics but focused instead on Central Planning. Consequently, the critique failed to generate a widespread interrogation of New Welfare Economics. Nonetheless, his point was an important one. Essentially, Hayek argued that it is not feasible to ascertain a single goal for society. Indeed, any attempt to implement a unitary goal will be illiberal because it must override the hopes and desires of some in order to obtain the unitary goal:

> The various kinds of collectivism, communism, fascism, etc., differ among themselves in the nature of the goal toward which they want to direct the efforts of society. But they all differ from liberalism and individualism in wanting to organize the whole of society and all its resources for this unitary end and in refusing to recognize autonomous spheres in which the ends of the individuals are supreme.[36]

It is no coincidence that Hayek's critique is almost identical to Mill's criticism of nineteenth-century socialist schemes put forward by Auguste Comte. Hayek was familiar with Mill's position and he noted with interest that Mill recognized one of the most vulnerable elements in Comte's political doctrines: Supposing the government should direct "all the forces of society" toward "some one end," how is society or the government to settle on one single end for all?:

> [T]he very first and fundamental principle of the whole system, that government and the social union exist for the purpose of concentrating and directing all the forces of society to some one end. He cannot mean that government should exist for more than one purpose, or that this

[35] Hayek, and before him Mill, argued that state intervention by definition implied the imposition of unitary goals upon the policy. In his study, Samuel DeCanio examines how the implementation of such goals is necessarily by monopoly means. See "Efficiency, Legitimacy, and the Administrative State," this volume.

[36] F. A. Hayek, *The Road to Serfdom: Text and Documents—The Definitive Edition, The Collected Works of F. A. Hayek*, Volume II, Bruce Caldwell, ed. (Chicago: University of Chicago Press, 2007), 100. "The 'social goal,' or 'common purpose,' for which society is to be organized is usually vaguely described as the 'common good,' the 'general welfare,' or the 'general interest.' It does not need much reflection to see that these terms have no sufficiently definite meaning to determine a particular course of action. The welfare and the happiness of millions cannot be measured on a single scale of less and more. The welfare of a people, like the happiness of a man, depends on a great many things that can be provided in an infinite variety of combinations. It cannot be adequately expressed as a single end, but only as a hierarchy of ends, a comprehensive scale of values in which every need of every person is given its place" (ibid., 100–101).

> one purpose should be the direction of the united force of society to more than one end. What a foundation for a system of political science this is! Government exists for all purposes whatever that are for man's good: and the highest and most important of these purposes is, the improvement of man himself, as a moral arid intelligent being, which is an end not included in M. Comte's category at all. The united forces of society never were, nor can be directed to one single end, nor is there, so far as I can perceive, any reason for desiring that they should. Men do not come into the world to fulfill one single end, and there is no single end which if fulfilled even in the most complete manner would make them happy.[37]

B. Endogenous goals

In 1954, Buchanan mounted a second, albeit largely unsuccessful, challenge to New Welfare Economics. The Virginia School economists united around a theme of potential learning, and especially learning via discussion. This view, which is linked to Buchanan's and Nutter's teacher, Frank Knight, added a complexity to the maximization problems posited by Arrow. It implied, for instance, that it was untenable to make cross-country comparisons of the type reviewed in Section II, when institutions varied. More than this, it was no longer straightforward to conclude that observed choices represented failures of optimization. This latter point was particularly important because, in the view of the early Virginia School economists, there was consequently much less warrant to devise policy recommendations for interventions to "fix" choices. The task that remained for the political economist was to study, and try to make sense of, people's choices. The Virginia economists focused instead on institutional reforms that would allow gains from trade; thus the slogan: politics as exchange.[38]

Arrow addressed the question of the political process in his 1951 *Social Choice and Individual Values.* There he demonstrated that a democratic polity of individuals who possess well-ordered preferences, something traditionally required for optimization models, exhibited reversals of social ordering. His result, (along with that of Duncan Black who independently made a similar case),[39] shocked the profession because it suggested that there was something wrong with democracy itself. Arrow's contribution was

[37] Mill to Gustav d'Eichthal, October 8, 1829, in *The Earlier Letters of John Stuart Mill, 1812–1848*, ed. Francis E. Mineka, volumes 12-13 of *The Collected Works of John Stuart Mill* (Toronto: University of Toronto Press, 1962–1991), 36. See my "Editor's Introduction" to *Hayek on Mill* for a detailed discussion of the parallel between Hayek and Mill in this regard, xxxviii–xxxix.

[38] This section draws on David M. Levy and Sandra J. Peart, *Towards an Economics of Natural Equals A Documentary History of the Early Virginia School* (Cambridge: Cambridge University Press, 2020).

[39] Duncan Black, *Theory of Committees and Elections* (Cambridge: Cambridge University Press, 1958).

profound: he demonstrated that instability prevails under eminently reasonable conditions of democracy.

Buchanan seems to have been the only contemporary commentator who suggested that Arrow's demonstration of unstable social ordering was actually a good feature of democracy, since there was no consensus in Arrow's society. Without consensus, an enduring decision would be premature, an imposition.[40] Here, Buchanan put his finger on the critical step between individuals and the group: Arrow's assumption that in the process of collective decision-making individual preference orderings do not change. For Buchanan, such an assumption was contrary to the liberal characterization of a democracy as government by discussion. Although Knight used the phrase often, crediting H. T. Buckle, the inspiration came from J. S. Mill's statement in *On Liberty* that until a people can be improved by discussion, they are not ready for democracy.[41] The profession largely neglected Buchanan's argument; more than fifty years later, Amartya Sen recognized its significance.[42]

In October 1960, correspondence with the Ford Foundation's program office, Kermit Gordon, Buchanan offered a clear statement of his view that group goals are endogenous to discussion.[43] Buchanan characterized New Welfare Economics as "social engineering" in which goals are exogenous:

> There seem to me to be two essential ways of approaching the study of problems of political, social, and economic organization. The first way is that of setting up independently certain criteria or goals for achievement and to examine existing and potential institutions in the light of their performance or expected performance in meeting these criteria.

[40] James Buchanan, "Social Choice, Democracy, and Free Markets," *Journal of Political Economy* 62 (1954): 114–23.

[41] J. S. Mill, "On Liberty," *The Collected Works of John Stuart Mill*, Volume 18, *Essays on Politics and Society Part I*, John Robson, ed. (Toronto: University of Toronto Press, 1977).

[42] "By clarifying the role of that momentous engagement in a truly outstanding pair of articles in the *Journal of Political Economy* in 1954, Buchanan immensely enriched the subject matter with which social choice as well as public choice has to be centrally engaged. In contrast with Arrow's initial inclination—as he put it—'to assume … that individual values are taken as data and are not capable of being altered by the nature of the decision process itself,' Buchanan had to insist that seeing 'democracy as government by discussion' implies that individual values can and do change in the process of decision-making" (Amartya Sen, "On James Buchanan," *Journal of Economic Behavior and Organization* 80 [2011]: 368). See K. J. Arrow, *Social Choice and Individual Values*, 2nd ed. (New York: John Wiley, 1963), and James Buchanan, "Social Choice, Democracy, and Free Markets," *Journal of Political Economy* 62 (1954): 114–23. In Sen's judgment, "It can be claimed that it is only through Buchanan's expansion of Arrow's departures that we can do justice to the Enlightenment enterprise of advancing rational decision making in societies, which lies at the foundation of democratic modernity" (ibid., 368).

[43] Levy and Peart, *Towards an Economics*, reproduce the full letter as well as the (unsuccessful) application to the Ford Foundation and related documents. At the time of the correspondence, Kermit Gordon was Director, Program for Economic Development and Administration at the Ford Foundation. Buchanan and his colleagues at the Thomas Jefferson Center applied in May 1960 to the Ford Foundation for $1.14 million to support the Center. Buchanan, Warren Nutter, and University of Virginia president, Edgar Shannon, met with Ford Foundation officials on August 31, 1960. They were unsuccessful in their attempt to obtain support.

> This approach, for purposes of exposition here, may be called the "social welfare function" or "social engineering" approach. It seems to characterize much of the current scholarship in the social sciences, and in economics especially.

He suggested that the approach of the Virginia School differs from the social engineering approach in that it takes group goals to be endogenous to discussion:

> The second approach is that which deliberately avoids the independent establishment of criteria for social organization (such as "efficiency," "rapid growth", etc.), and instead examines the behavior of private individuals as they engage in the continuing search for institutional arrangements upon which they can reach substantial consensus or agreement.

The commitment to liberty is a requirement in that participation in the selection of goals is widespread.

> It follows from this difference in approach itself that "individual liberty," in the sense of individual participation in the choices of appropriate constraints on human action, will tend to assume a necessary, and hence more prominent, role in the second than in the first. It is also true that the second approach will normally tend to place more emphasis on market organization than the first, not because there is some preconceived dogma or creed in favor of this form of social order, but simply because it does represent one system upon which substantial consensus has been, and is, expressed.

By removing the supposition of fixed goals, the Virginia School fundamentally altered the potential role of the economist as policy advisor or within the administrative state. No longer was the economist to implement policies in accordance with some expert-determined goals for society. Instead, the role of the economist was a more modest one of offering suggestions for public consideration. In 1959, Buchanan urged the observing economist to propose Pareto-improving social changes.[44] If a change is adopted, the economist's suggestion is a good one, and if it is not adopted the suggestion is unsound. It is important to notice that Buchanan's proposal does not require that the economist possesses a complete understanding of people's desires. There are many reasons why the proposal might be rejected; lack of understanding is but one.

[44] James Buchanan, "Positive Economics." For a contemporary extension of Buchanan's opposition to the expert-imposed goal of efficiency, see Paul Dragos Aligica, Peter J. Boettke, and Vlad Tarko, *Public Governance and the Classical-Liberal Perspective: Political Economy Foundations* (Oxford: Oxford University Press, 2019).

Buchanan's 1959 paper also contained a critical step in the development of the position that politics is exchange. In this context, he addressed the question of compensation for harms caused by policy changes. The context was how to respond to Robbins's point, noted above, that interpersonal comparisons of well-being are not matters of science but of ethics. One popular answer to Robbins, indeed the basis of New Welfare Economics, is that the *possibility* of making no one worse off in the course of a reform is sufficient to avoid his challenge. In contrast, Pareto's criterion requires realized compensation so that someone is *actually* better off and no one is the worse. Here, the orthodox tradition divided. Buchanan's position was in line with Arrow's, with both claiming that possible compensation was not a solution to the challenge. Only actual compensation counted. To this, Buchanan added that if people are sympathetic, the range of acceptable compensations (trades) widens.

VI. Conclusion

This essay has focused on the narrow question of how economists treat private and public incentives as they relate to policy recommendations and implementation. Yet there are wider lessons to be learned. First, in the context of the family size decision, the foregoing reveals that economists' views on this altered significantly over time. On the one hand, Besant, Bradlaugh, and J. S. Mill trusted that individuals would make reasonable family size choices using information about how to prevent births and the attendant misery associated with overpopulation. More information was seen as better than less and need not be hidden from poor people or filtered through the intermediary of a physician. On the other side of this divide—and recognized as such at the time—Darwin and Greg provided cautionary notes. Widely available information might, they urged, dilute the effects of natural selection and weaken the institution of the family. After Darwin, who was more careful on this subject, experts like Greg and others showed a remarkable willingness to lay aside the happiness of some for the "progress" of the race.

Two central questions emerge. First, what was the role of economists in developing the case for policy interventions? Second, did they self-consciously develop this case, knowing the dangers associated with overriding individual goals in the name of social progress? The foregoing has demonstrated that their role was substantial and that they were willing participants in the sacrifice of happiness in service of a purportedly higher goal, whether that goal was "racial betterment" or "efficiency." It is important to recognize that the mismatch of incentives may extend to the modelers (economists), acting within the administrative state, those who implement policy.

The foregoing also suggests that it is important to keep in mind that the administrative state comprises individuals who possess more or less

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scientific information regarding the tasks they undertake. The worry is not so much that they are bad people or even people who make bad choices. They may be doing what is best for the polity, with science to support their choices. But perhaps not. The worry highlighted in this essay is that they are people, like any other people, subject to private motivations. They may be overly confident in their knowledge of what is "best" for individuals, and that confidence may empower them to override agreed-upon social norms and individual choices in service of the so-called goal of social betterment.

This suggests that the "solution" to the "administrative state" is at best partial, consisting first and foremost in awareness and recognition, and secondly in finding ways to mitigate against administrators' incentives to override or fill in gaps in the public consensus.[45] From a modeling perspective, that of the economist seeking to provide advice to the administrative state, awareness is, again, a crucial first step.

Finally, it is important also to emphasize that the foregoing has focused on how social goals are determined and implemented, and how they relate to private goals and pursuits. This stands in contrast with the more common discussion of government activity that focuses instead on the size of the public sector. While those who favored allowing individuals to pursue their private goals of happiness may have also favored fewer restrictions on individuals, and thus a smaller administrative state, their position was not driven by an overarching desire for a small administrative state. Rather, fewer restrictions were a result of their overarching desire to recognize and give warrant to the hopes and desires of individuals.

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[45] In this respect, my argument is an extension of the case David Levy and I have made regarding experts. In *Escape from Democracy*, we suggest that awareness that experts are motivated by private desires and hopes is a first step toward obtaining the benefits of expertise while reducing the risk associated with uncritical acceptance of their recommendations.