ONE

Introduction

Towards a Reinterpretation of the History of Welfare Economics

Roger E. Backhouse and Tamotsu Nishizawa

I. PLACING WELFARE ECONOMICS IN CONTEXT

Towards the end of the 19th century, the laissez-faire ideology that had dominated Victorian Britain was increasingly called into question. There was great prosperity yet poverty remained endemic. London's poor East End was, for the middle classes, a dangerous foreign world quite unlike the areas in which they lived. Socialism was in the air. This term could denote a wide spectrum of positions, from Marxism and other forms of revolutionary socialism at one end to municipal socialism, centred on local authority provision of public goods and services, from sewers to street lighting, at the other. There were also important national initiatives in areas such as education. Such concerns were given impetus by the extension of the franchise to the working class, in 1867, 1884 and 1918, and by the rise of organised labour and the Labour movement, culminating in the displacement, in Parliament, of the Liberal Party by the Labour Party. Questions about the functioning of a capitalist economy became even more acute with the economic turmoil of the inter-war period, culminating in the Great Depression, when capitalism seemed, to many, to have failed. After 1917 there was, in the Union of Soviet Socialist Republics, an alternative with which comparisons could be made. However, as in the late 19th century, the issue facing most economists was not whether capitalism was so flawed that it needed to be overthrown but whether its faults could be put right by measures that fell far short of a Soviet-style command economy. John Maynard Keynes, in his *General Theory* (1936), pointed to one apparent limitation of capitalism – its inability to keep workers and resources fully employed and suggested ways in which it could be made to work better.

This was the background to two developments that have hitherto been considered separately. One was the emergence of what, after 1945, came to be called the welfare state: a state-provided system of universal health care, old age pensions and provision for support of those who were unemployed or incapable of work, funded by moderately progressive taxation. The other was the development of a body of principles for evaluating policies that the government might pursue: what was labelled by its most influential proponent, 'the economics of welfare', or welfare economics. By 1945, this had developed as a widely agreed upon and well understood set of principles, which from the 1950s were formalised in a series of textbooks.

There is a sense in which economists had always been concerned with welfare (see Myint 1948). Rising incomes meant rising living standards, and political economists could explain why allowing people to pursue their own interests would produce outcomes that were generally in the public interest. It was also possible to provide convincing arguments that individuals acting individually through markets (the key feature of capitalism) would fail to ensure certain goods were produced, the classic statement being that of John Stuart Mill in the final chapter of his *Principles* (1848). However, it is misleading to call this welfare economics, because economists had no techniques for analysing welfare as anything different from production. The framework for the analysis of welfare as something different from total production was provided only towards the end of the century. In 1871, William Stanley Jevons, strongly influenced by contemporary experimental psychology, took up Jeremy Bentham's ideas about utility maximisation. When combined with mathematical methods taken from physics, the result was a mathematical theory of individual behaviour, focusing on utility, which could be taken as a measure of individuals' welfare. If different individuals' utilities could be added up (something Jevons was very cautious about doing) the result was a measure that could be used, as Bentham had argued, to measure welfare.

The person who applied this most systematically to problems of welfare was the Cambridge philosopher, Henry Sidgwick. In his *Principles of Political Economy* (1883 [1901]) he used utilitarian arguments to argue that there were two ways of measuring wealth: goods could be valued using prices or according to the utility they created. Because the price of a good is not related to its average utility, the two measures would not be the same. Though he did not use this terminology, Sidgwick drew a clear distinction between wealth (understood as income) and welfare. Furthermore, marginal analysis provided tools with which the limitations of free markets could be analysed. He went on to draw up a much longer list of cases where government intervention was required than could be found in Mill. Cambridge welfare economics was then developed by his Cambridge colleagues and successors, notably Alfred Marshall (1920) and A. C. Pigou (1920), who provided the tools that could be used to analyse the limitations of the capitalist system much more effectively than Sidgwick had been able to do. Though they moved away from utilitarianism, either as an account of behaviour or as an ethical system, their analysis retained many utilitarian characteristics. In Pigou's hands, Cambridge welfare economics, as it came to be known, provided arguments for an extensive programme of government intervention.

Conventional accounts of welfare economics proceed from Cambridge welfare economics to the attack that was mounted on it in the 1930s. A simplified account of this runs as follows. Up to 1930, welfare economics was, in Britain, virtually synonymous with Pigovian welfare economics. In his *Essay on the Nature and Significance of Economic Science* (1932), Lionel Robbins argued that the inter-personal utility comparisons implicit in the adding together of different individuals' utilities, as required by the Cambridge method, were matters of individual judgement, for which there was no scientific basis. They should, therefore, be banished from economic science. At the same time, two of Robbins's young colleagues at the London School of Economics (LSE), John Hicks and Roy Allen, had shown that it was possible to base a theory of individual behaviour on nothing more than assumptions about preferences, dispensing with the notion of utility altogether. One might use 'ordinal' utility, attaching numbers to different levels of well-being, but these numbers had no significance beyond indicating how different bundles of goods were to be ranked. It was meaningless to add them together.

Faced with this challenge, Cambridge welfare economics was no longer tenable. Attempts were therefore made to reconstruct welfare economics on foundations that did not include utility. Hicks and other young theorists turned instead to the continental tradition that flowed from Jevons's French contemporary, Léon Walras, to the Italians, Enrico Barone and Vilfredo Pareto. Welfare criteria were developed that relied on knowing only individuals' preferences. If making a change made one person better off, but made no one worse off, that must be an improvement, says the criterion eventually named after Pareto. The problem was that this was a very weak welfare criterion indeed because, in practice, virtually any change that made someone better off would make someone else worse off. Because it was impossible to measure how much better or worse off people were, it was impossible to say anything in such cases without an additional criterion. John Hicks, Nicholas Kaldor and others sought this in compensation tests, an idea floated by Pareto, that a change was an improvement if the winners could compensate the losers and still remain better off.

Much of the history of welfare economics is correct. However, it is seriously incomplete in ways that have dramatic implications for how these developments should be interpreted. The conventional story fails to look outside academic welfare economics, paying no attention to economists' awareness of social problems. Yet this is a period when social problems were at the forefront of economists' concerns. The Cambridge view of the relation between academic economics and social reform can be represented by Marshall. As is well known, he came into economics because of a desire to understand and deal with the problem of poverty. Though they might as individuals become involved in the Settlement Movement or the Charity Organisation Society (COS), the Cambridge economists, from Marshall onwards, sought to create a scientific economics, set apart from the political process. Their relation to the political process was typically that of advisers, giving evidence to Royal Commissions or publishing analyses on which policy makers could draw.

At Oxford, on the other hand, the relation between academic ideas and involvement in social and political reform was different. The home of the Oxford Movement, with its integration of High Church Anglican Christianity and social involvement, produced economists who became directly involved in politics. The generation that included L. T. Hobhouse, J. A. Hobson, Bernard Bosanquet and William Beveridge left Oxford to become civil servants, journalists and politicians, actively involved in creating some of the institutions that developed into the welfare state. They provided much of the intellectual framework for the reforms that came with the Liberal government of 1906, the first to include Labour representatives. Within the space of a few years, the government introduced a range of radical measures from progressive income tax to labour exchanges and unemployment benefits.

Given that Marshall moved into economics because he wanted to address the problem of poverty, and that many other economists were concerned with these issues, it is surprising that the links between welfare economics and the welfare state have been neglected. The reason this changes the history so significantly is that it brings in Oxford, where the intellectual basis for reform was very different from that offered by Cambridge. The background common to both universities was the perceived inability of Christianity, any longer, to provide an acceptable foundation for ethics and the resulting need to find an alternative. However, whereas Cambridge largely developed the utilitarian tradition, Oxford turned instead to idealism. Where Cambridge had Sidgwick, Oxford had T. H. Green and John Ruskin. Though none went so far as to argue against the existence of capitalism, many of those who came out of Oxford, such as Hobson and R. H. Tawney, held much more radical views on the limitations of capitalism than did their Cambridge counterparts. There was no rigid divide (Marshall, for example, was influenced by his brief experience at Oxford and paid great attention to Kant)[1] but the Oxford–Cambridge divide provides a useful way of characterising two attitudes to the study of social problems and responses to them.

To set the scene for the chapters that follow, the first theme that needs to be clarified concerns the location of thinking about welfare at the interface between academic economics and the policy process. This problem is addressed in the next section. The argument then turns, in Section 3, to the contrast between utilitarianism and idealism as foundations for the analysis of welfare and the welfare state. Sidgwick is compared with Green, and the key features of Ruskin's critique of capitalist society are outlined. Section 4 then outlines the subsequent chapters.

2. Economists, the academy and politics

The story of welfare economics from the 1870s to the First World War centres on two figures: Henry Sidgwick (at Cambridge) and Thomas Hill Green (at Oxford). They were friends from an early age, whose careers had much in common. Both contributed to establishing ethics as an academic discipline: Sidgwick through his *Methods of Ethics* (1874) and Green through his teaching at Balliol and, to a lesser extent, through his posthumous *Prolegomena to Ethics* (1883).[2] In their different ways, both were inspirational figures for their generation.[3] However, their careers also diverged in ways that, quite apart from their philosophical differences, considered in detail in Section 3, help explain the difference between the welfare economics that came out of Cambridge and Oxford.

[1] Though note that Groenewegen (in Chapter 2) argues that the influence of Oxford on Marshall should not be exaggerated. On Marshall's attitude to Kant, see Cook (2009).
[2] See Richter (1964).
[3] See footnotes 2 and 5.

Sidgwick and Green were both members of the group of 'academic Liberals' who sought to enter politics in the 1860s. Faced with the extension of the franchise to the working class, a process started with the 1867 Reform Act, they believed that academics had an obligation both to help educate the new electorate and to provide enlightened leadership. Education for newly enfranchised adults was provided by the university extension movement. Leadership was to be provided by academics standing for Parliament. They were radicals, successors to the earlier Philosophic Radicals, wanting reform of society, in particular to reduce the role of the church and the aristocracy. In 1868, 19 of their number were elected and they were full of hope that Gladstone's administration would fulfil this aim of reforming society on a rational basis. However, these hopes were rapidly dashed when it became clear that religious interests were still sufficiently strong to prevent the educational reforms that were needed. An Education Act was passed in 1870, but the radicals felt let down because it left the churches in a strong position in providing education. When Gladstone regrouped the Liberal Party, it was on the basis of foreign policy. The new electorate was revealed as conservative, and a barrier to reform. It was necessary to find a new way forward.

Another of the academic Liberals, Leslie Stephen, assessed the problem in the following terms:

> For a solid reform therefore we must look to the gradual infiltration of sound beliefs through the whole social organism, which must end by bearing the fruit of an intelligent loyalty to trustworthy leaders. The change must be inward before it can be outward: no shuffling of the cards can make them all turn up trumps; it is a new force that is required, not a new machinery; and all constitution-mongering is thrown away till a new spirit has been breathed into the dead bones. (Stephen [1875], quoted in Harvie 1976: 198)

The relation between academia and politics needed to be re-assessed. In order to bring about this 'inward' change, many Liberals retreated from Parliament, and resorted to single issue politics – the temperance movement, public health, public education and poor relief.

Sidgwick's response was to explore the foundations of ethics, political economy and politics in a series of weighty tomes, each offering a meticulous analysis of the problem in hand. In response to Marshall's comment that his lectures failed to attract more than a handful of students (in contrast to the hundreds who were inspired by Green), Sidgwick responded that he could not do anything to make his philosophy more popular (Sidgwick and Sidgwick 1906: 394–6). Though it was Marshall, whose work rested on philosophical foundations that were different from Sidgwick's,[4] who established the Cambridge school, the process whereby economists became academic experts, distancing themselves from direct political involvement, can arguably be traced back to Sidgwick. One could not say the same of Green's influence. Sidgwick's *Principles of Political Economy* (1883 [1901]) used utilitarian arguments to make a case for government intervention that went beyond what his predecessors, such as Mill, had advocated, but he remained conservative in his outlook, with views that were largely those of traditional Liberalism. Thus he was involved in the COS, an organisation established in 1869 to tackle the problem of poverty by ensuring that poor relief was not handed out inappropriately: it would harm its recipients' moral character and hence undermine their ability to help themselves.

Green also 'retreated' to academia, and shared many of Sidgwick's classical Liberal views. However, his teaching in Balliol had a very different effect. Unlike Sidgwick, Green remained within the Church of England, seeking to reinterpret Christianity as an ethical creed. Students might come away from his lectures without having understood a word, but inspired by the call of duty. This consciously moral outlook on social problems was reinforced by John Ruskin, who became Professor of Fine Arts in 1869, offering a denunciation of the life-threatening values of commercial society and political economy. Perhaps their most influential student was Arnold Toynbee whose lectures on the Industrial Revolution used history to reinforce the moral critique of capitalist society, though, like his teacher, Green, he resisted socialism: reform was to come about through improvement of character. He threw himself into the university settlement movement, and after his death, in 1883, at the age of 30, he was lionised as if a martyr. The combination of Green, Ruskin and Toynbee inspired a generation of students, including many historically-minded economists whose careers were dominated by questions of social reform. Even more than their Cambridge counterparts, many of them went into the extension and settlement movements, exemplified by Toynbee trust and Toynbee Hall. Some retained Green's liberal values, but others moved in a more collectivist direction, especially after the 'bitter cry of outcast London' came to their attention in the 1880s (see Stedman Jones 1984). Bernard Bosanquet and J. H. Muirhead, like Sidgwick, were

[4] This brief summary glosses over much. For a detailed discussion of Marshall's differences from Sidgwick, see Raffaelli (2003), Cook (2009) and the essays by Raffaelli and Cook in Raffaelli, Becattini and Dardi (2006). See also Backhouse (2006).

Cambridge University Press
978-0-521-19786-1 - No Wealth but Life: Welfare Economics and the Welfare State in Britain, 1880-1945
Edited by Roger E. Backhouse and Tamotsu Nishizawa
Excerpt
More information

supporters of the COS. John Atkinson Hobson, Leonard Hobhouse and Graham Wallas moved towards the Fabians (though Hobson remained a Cobdenite Liberal in many respects). Of these, 'the two Hobs' became the leading intellectual spokesmen for a New Liberalism of social reform (Clarke 1996: 43).

In contrast, the Cambridge welfare economists became professional academic economists in the modern sense. Marshall sought to professionalise economics. Pigou did for the economics of welfare, whose 'official' history starts with his *Wealth and Welfare* (1912), what Marshall did for economics in general with his *Principles*. The latter begins by trying to show that what is good for economic man is normally good for 'total man'; Pigou's *Wealth and Welfare* begins by postulating this. They sought to observe the positive-normative distinction and engaged in economic analysis that was separate from their policy advice. This analysis might comprise dry logical dissection of problems (as in Sidgwick's major books) or technical mathematical arguments such as used by Marshall, or Pigou, or it might be analysis of specific problems of policy. A major exception was the Tariff Reform Campaign of 1903, where Marshall, Pigou and others sought to enter political controversy directly. Even here, however, they were seeking (with disastrous consequences) to impose the authority of an economic science that lay above the political arena.

In contrast, the Oxford economists and their students became involved much more in organisations designed to have a direct influence on policy or social reform. They might not seek to enter Parliament, but they did not retreat into academia. Some went into journalism (e.g., Hobson and Hobhouse) and many became involved in groupings such as the New Liberals and the Fabian Society. Hobson and Hobhouse worked alongside politicians such as Samuel and Haldane (both Ministers in Asquith's 1908 government) and Ramsey McDonald (later Labour prime minister). Sydney Olivier and Graham Wallas (both Oxford products) founded the Fabian Society with George Bernard Shaw and Sidney Webb. Perhaps more significant, there was no demarcation between the economic and the political; they were political economists in a fairly literal meaning of the term. This overlap of the political and the economic is shown more clearly in Hobson's writing, where his ideas on welfare were developed not only in books that addressed the problem specifically, such as *Work and Wealth* (1914), but also in clearly political writings, such as *The Crisis of Liberalism* (1909) or *The Social Problem* (1901), or in the close cooperation that developed between him, Hobhouse and Wallas. A similar difference in attitude is also found in economic and social history. In the hands of John and Barbara Hammond or R. H. Tawney, history could, in the tradition of Toynbee's *Lectures on the Industrial Revolution*, be used to make a clearly political point. In contrast, Cambridge's J. H. Clapham wrote economic history that served purely academic purposes.

The contrast was not absolute. From Oxford, Llewellyn Smith, Michael Sadler and Beveridge became bureaucrats, as did the Cambridge economists Sydney Chapman and Walter Layton, whereas Keynes falls into a category of his own, so varied were his activities. There was, however, a significant difference in emphasis. In the inter-war years, many from Oxford became associated with LSE. Wallas became Professor of Political Science, Hobhouse Professor of Sociology, Tawney Professor of Economic History and Cannan Professor of Economics. Hobson had no permanent position but undertook some teaching there.

This group constituted the core of the group that the American Walton Hamilton (1919: 318) labelled 'the English school of welfare economics'. Although this clearly suggests a parallel with Pigovian welfare economics, the similarities should not be pushed too far. Though Marshall and Pigou used different methods, they were engaged in the same enterprise – developing and applying a set of techniques that could identify beneficial changes in the way economic activity was undertaken. This was also the goal of the new (Paretian) welfare economics that was developed in the 1930s and 1940s. Hamilton's 'English school of welfare economics', on the other hand, hardly merited being described as a school given the variety within it. What united them was a willingness to apply to the problem of evaluating economic activities a more detailed and stronger ethical criteria than those the Cambridge economists were willing to employ, leading them all to adopt an approach to welfare economics that was very different from that found in the Cambridge School. Beyond that, the differences among, for example, Hobson, Cannan and Tawney were profound both as regards specific judgements made and as regards the extent to which they sought to develop new conceptual tools. As Maloney (1985, 183–4, 232) has expressed it, the battle to professionalise economics was primarily a battle between those who saw it as a discipline comparable to the natural sciences and those who saw it as an adjunct to immediate social reform. The former inclined to an absolutist method involving 'scientific' tools where the latter inclined to a historical-relativist method.

There are further explanations that must be appended to the claim that the crucial distinction that needs to be made in this context is between

Cambridge and Oxford. The first is that, though it can be argued that ideas coming out of Oxford had more effect on politicians, and hence on the movement towards the welfare state, influence is hard to establish. The changes that led to the creation of the welfare state were not the result of directly applying economic theory – it was not 'welfare economics in action'. They were political events that were dependent on the broad range of social factors that typically underlie major historical changes. It is often very difficult to establish clear links between ideas and the resulting policies. For example, it has been argued that Hobson's arguments about the surplus had more effect on the move towards progressive taxation in Lloyd George's 'People's budget' of 1908 than more orthodox utilitarian arguments. Hobson did move in the circles frequented by decision makers, and his views were certainly more important in influencing the climate of opinion on taxation, than would be suggested by his almost complete neglect among historians of academic economics. However, the evidence is speculative and circumstantial, as is often the case. Apart from the problem that political events typically have multi-layered causes, there is the problem that politicians pick up ideas from surprising sources. Toye, in Chapter 8, illustrates this by showing that Churchill and Lloyd George may have been persuaded to adopt certain welfare policies, not as a result of arguments by economists (whether defined to include Hobson or not) but by H. G. Wells. Wells, of course, was associated with the Fabians and thereby with the Oxford side of the division discussed here, but he was by no stretch of the imagination an Oxford economist. In his hands, ideas were given new twists. In the same way, Sidney and Beatrice Webb, who had even stronger connections, through LSE, with Oxford economists, and of whom Sidney was classified by Hamilton as a welfare economist, were not themselves from that tradition.

3. Idealism, utilitarianism and morality

The two men who lie at the roots of the ideas discussed in this book, Sidgwick and Green, offered contrasting philosophical foundations for the subject: utilitarianism and idealism. However, despite this difference, they were both responding to the mid-Victorian loss of religious faith caused by the results of biblical criticism emanating from Germany and the evolutionary ideas associated with Charles Darwin and Herbert Spencer. They both struggled with this crisis of faith, the problems they faced resonating with those of their friends and students. Sidgwick is