Fallacies of W

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THE TERM cost-benefit analysis is now an accepted part of the jargon of politics. Not long ago it was used only by a small group of specialist economists. For those who wish to sound progressive and businesslike, it is a safe cliché: it builds the desired image without provoking awkward questions. Everyone is vaguely conscious that this is a technical subject unsuited to popular exposition. Perhaps it is. But its assumptions go to the very root of politics, and they are the concern of all. If governments use a formula to decide how our resources are to be allocated as between, let us say, hospitals, roads and schools, then we must know what it is, if not in detail, at least in essence.

The essence of the matter is the deceptively simple concept of utility. In both economic and political theory, this is a term that has been contrived as a means of generalising about human behaviour. In economic theory it is used to describe the way in which a consumer makes choices among various "parcels" of goods. If, for example, a particular consumer would prefer a parcel containing one hundred cigarettes and a half-pound of chocolates to one containing fifty cigarettes and a pound of chocolates, then it is said that the former parcel affords him more utility than the latter.

There is an obvious analogy between a consumer budgeting his expenditure to get the maximum of personal utility and a nation regulating the use of its resources to yield the maximum of social utility. The whole question is whether there is any way of bridging the gap between personal utility and social utility.

There is nothing particularly obscure about the idea of social utility, but as a concrete quantity it turns out to be tantalisingly elusive. So long as we choose illustrations with care, its meaning is clear. A sanitation system contributes to social utility: the odour of a gas works detracts from it. But one has only to recall, for example, the controversy over Stansted airport to realise that life is seldom simple. Not everyone benefits to the same extent, and the costs (or loss of utility) are liable to be distributed very unevenly.

The intrusion of the need to make a fair settlement among those affected is a serious inconvenience to the construction of a theoretical formula. Realising this, economists have evaded this aspect of the problem by attempting to separate the idea of social utility from the idea of social justice. Let us (they say) try to solve the problem of social justice. The needs of social justice can always be met by some combination of taxes and subsidies.

Having thus put aside the moral problem, the economists have proceeded to construct upon the foundation of utility a body of theory called "welfare economics" in much the same way as Euclid's geometry had been constructed from the idea of a straight line as the shortest distance between two points. It was only after some massive volumes of theory had been written that it was realised that some implied value judgments had crept into the analysis. In other words the intended separation between justice and utility had not been consistently maintained. With the implied value judgments removed its results became much less impressive.

Although many of the results of welfare economics have thus been discredited, some of what remains is not without interest. For example, it provides a logical proof that one way by which maximum utility can be achieved is by allowing all decisions to be made by the operation of pure competition and free trade This result is, however, of limited application to real conditions (as was immediately pointed out). The standard textbook example of an exception is that of a factory-owner planning to build a chimney. Since the harm done by the smoke to the surrounding houses it not a cost borne by the owner, it does not enter his calculations, and his best plan will therefore be to build the chimney just high enough to avoid damage to his own property. The choice that gives maximum utility to the owner does not therefor yield maximum social utility. In the jargon, there are "external costs" which are borne by the community. Only if chimney building could be a matter of free bargaining among everyone affected could the conditions for maximum utility be restored.

This example is, of course, only one of many. The building of airports and trunk roads provides others, and there are many examples of external benefits as well as of external costs. The effect of land-value taxation upon such situations could clearly be important, but has not received much attention from economists.

In the world as we know it there are a great many departures from free competition. Wage rates and interest rates are to a considerable extent determined administratively. There are private monopolies that raise prices by restricting output, and there are public monoplies, some of which make no direct charge for their services. If in these circumstances resources were allocated without planning in such a way as to yield maximum social utility, it would only be by remarkable coincidence.

These imperfections, together with the question of external costs and benefits, are the justification that welfare economics gives to economic planning. This dilution of the strong case for free competition goes, significantly, under the name of "the theory of the second best." Despairing of a radical change of institutions, the proponents of this theory envisage government planning as a way of correcting the distortions induced by market imperfections and of thus increasing social utility. But this theory is largely a negative one: it does not say how!

The real weakness of the pure theory of welfare economics lies in its attempt to evade political questions.

Welfare Economics

K. GARDNER

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If Ellen prefers marmalade and David prefers jam, no conceivable feat of economic reasoning can tell us how to get the maximum utility for Ellen and David together. There can be no objective standards by which the strengths of their preferences could be measured. Since, because of this, we cannot add their utilities, we cannot speak logically of their combined utility, still less that of a whole community.

Yet such choices are made on a national scale, with the consent of the community, if not with their approval in individual cases. It is not feasible even in a democracy to have a plebiscite every time an economic choice has to be made. As a matter of intellectual curiosity it is interesting to consider what would be the outcome if such matters were determined by plebiscite. There is now a body of theory dealing with this question called "the theory of democratic group decisions." The problem of defining democracy in the terms of welfare is answered in this theory by "a democracy is an organisation that enables the majority to impose social costs upon the minority." If this definition excites revulsion, it may prompt some thought concerning the nature of politics

The idea of utility as a criterion of government action has its origin not in economic theory but in political theory. It was applied by Bentham in the eighteenth century to the problem of crime and punishment, and extended to build a complete theory of government The belief that governments exist for the good of the people had. of course, been a part of the European tradition since the days of ancient Greece. But medieval thinkers had imposed upon this concept an essentially authoritarian view of the good of the people. When Aristotle had said that the function of government was to make men good, he probably meant good citizens. His medieval followers required governments to "coerce men from evil" and invoked the authority of the Church to determine what was to be considered evil. What Bentham and the Utilitarians tried to do was to replace this authoritarian theory by one in which the utility of each citizen *as seen by himself* would be the criterion.

Here, you might say, was the first attempt to separate moral justice from utility. But the Utilitarians did not see it this way. They simply denied that, as far as government was concerned, there could be any moral principle except utility or the "greatest good of the greatest number." It was a liberating philosophy, but an inadequate one: quite unable to explain the great feeling for justice expressed, for example, by Wilberforce's successful campaign to free the slaves.

Even within its own limitations, the philosophy failed to provide any agreement concerning the practical problem of finding out what constitutes the greatst good. The Utilitarians hoped that democracy would provide a solution. Their attempts to indicate how the intensity of individual preferences might be allowed for were not particularly helpful, but they did acknowledge that it would not be right to impose severe deprivation upon a minority to satisfy a mere preference of the majority. John Stuart Mill in his famous essay *On Liberty* warned against a "tyranny of the majority" and sought to limit the scope of government action. He tried to draw a distinction between "self-regarding acts" and those that affect others, but got into a muddle that has been used as an object lesson by teachers of logic ever since.

One way—perhaps the only way—by which the intensity of a person's preference can be measured is by seeing what he is prepared to forego in order to have the object preferred: in short, by the price he is prepared to pay.

If this way of looking at prices and preferences is to be pursued logically, it has to be recognised that the concept of preference must not be confined to goods and services. For every individual, there comes a point at which he is prepared to forego any further earnings for the sake of some leisure in which to enjoy them. This has led welfare economists to speak of "the price of leisure." For any individual, the price of leisure is measured by what he is prepared to forego in order to have it: namely, his wage rate. It follows that the utility enjoyed by the community as a whole will be reduced unless each individual is free to balance the benefits of working against its costs in loss of leisure.

Clearly, the logic of welfare theory would not be complete unless it included a consideration of how wages should be determined. The theory shows that a perfect solution is obtained if each man's wage is equal to his "marginal product"—that is to say to the value of the additional goods produced by his efforts. This, they say, is what would happen if wage rates were to be determined by free competition, and what has to happen if the community is to enjoy the maximum of utility.

In drawing this conclusion, economists have implicitly assumed that wealth is distributed only in the form of either wages or interest. They have in fact assumed the private appropriation of land rent out of existence. Since this assumption is essential to their conclusion as to how to get maximum utility, their own arguments can be used to show that land-value taxation is a necessary prerequisite.

Now that the fallacies of welfare economics have been exploded, it provides what could be a most powerful tool of argument. It can be used to show that governments have set us a series of objectives (such as economic growth, balance of payments surplus, and so on) which are in fact entirely unrelated to the welfare of those whom politicians are elected to serve. It can show where our present institutions are imperfect by indicating where utility is lost. And, above all, it can show that the ideas of social justice and economic welfare are inseparable.