The Hesitant Hand: Mill, Sidgwick, and the Evolution of the Theory of Market Failure

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The theory of market failure brought analytical refinement to a centuries-old concern with the impact of self-interested behavior on economic activity.[1] The preclassical commentators looked for a means to coordinate or restrain the base effects of self-interested behavior and saw no means other than government regulation and religious control—both rather centralized, authoritarian, and pessimistic regarding the effects of self-interested behavior. The idea that self-interest could somehow promote the general welfare was essentially absent.[2] Adam Smith and the nineteenth-century classical economists saw the system of natural liberty harmonizing, to a greater or lesser extent, self-interest and social interest, allowing the market to function with a minimum of direct control by government. However, the 1870s and the several decades afterward—which brought us the marginal revolution and the subsequent development of

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1. Medema 2003 provides a general overview of this topic.

2. Courts, monarchs, and legislative bodies, however, did begin to lay the legal foundations for a market economy in the fourteenth century and continued that work into the seventeenth.

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neoclassical economics—saw the pendulum swing back to a greater degree of suspicion about the effects of self-interested behavior. Specifically, as against the classical faith in the system of natural liberty and the attendant suspicion of state intervention, we see in the literature assertions of a rather extensive set of divergences that the market could not satisfactorily coordinate—market failures—and the argument that government could serve as an efficient coordinating force.

The onset of the marginal revolution also precipitated a change in the way that economists went about their *analysis of* the economic role of government. As William Baumol (1952, 154) has pointed out,

> With the Jevonsian revolution, French, Italian and English speaking authors were led, under the influence of positivist philosophy, to shy away from ethically normative discussion. Discussion of the duties of the state had generally amounted to a specification of the authors' preconceptions as to what ought to be, and this sort of analysis was not in keeping with the new approach.[3]

Writings on public finance no longer began with an elaboration of the appropriate role of government;[4] rather, they were confined to a discussion of how the revenues necessary for the operation of government should be garnered. The discussion of the appropriate role for government now took place in the newly emerging welfare economics. But it was more than the positivist philosophy that drove the further developments here. Externally, economists of the late nineteenth and early twentieth centuries saw the effects on society, both positive and negative, of widespread industrialization, and this caused some to begin rethinking certain aspects of the received view of the market. At least as important, though, was an internal force: the *tools* of marginal analysis made possible derivation of market optimality conditions and thus the *demonstration* of the potential failings of the system of natural liberty. With this came the related demonstration of the possibilities offered by governmental policy actions for promoting, rather than diminishing, social welfare.

This essay attempts to shed some light on the transition from the fairly noninterventionist approach of the classical tradition to the more interventionist orientation that came to characterize neoclassical welfare theory

3. See Buchanan 1960 and Medema 2005 for discussions of the Italian perspective.

4. Sir William Petty's *Treatise of Taxes and Contributions* (1662) is an excellent early example of this method—one we see carried through in Smith's *Wealth of Nations* as well.

and public economics. The argument here is that this transition occurred via a two-stage process, in which John Stuart Mill and Henry Sidgwick were central players. The first step involved the elaboration of a greatly expanded theory of the failure of the system of natural liberty—akin to what we today call "market failure"—as against the classical view.[5] Mill was instrumental in this expansion, and it continued at the hands of Sidgwick. The second stage involved the move to a much more markedly positive assessment of the possibilities of corrective policy actions undertaken by the state than we find in the classical tradition, and it was here that Sidgwick took center stage. All of this fed into Cambridge welfare theory, the market failure aspect of which, at least, came to dominate professional discourse. I will thus attempt to show how the writings of John Stuart Mill and Henry Sidgwick represent a departure from that which came before, the forces that led them to their respective views, and the role these ideas played in the development of the more expansive role for government evidenced in early stages of welfare economics.

Nineteenth-Century Classical Economics: Pragmatism Meets Self-Interest

The misleading nature of the caricature of the nineteenth-century classical economists as die-hard proponents of laissez-faire who hold a homogeneous view of the economic role of government has long been evident to serious students of the history of economic thought.[6] Lionel Robbins (1952) has elegantly laid out the case for the reformist nature of the classical economists, who were critical of a number of the institutional arrangements of their time and highly optimistic that the insights of political economy could be used to point economic policy in a direction that would be beneficial to society. This new science would be an indispensable part of the policy-making process and help to arrest the more negative effects of partisan advocacy within that process.

The nineteenth-century classical economists, like Smith before them, had a strong belief in the market as an allocation mechanism, but they also

5. This has several aspects: stability failure, distribution failure, and allocation failure. The focus of the present essay is on the last of these. Backhouse 2006 contains an excellent treatment of the ethical underpinnings of the Cambridge tradition, including the relationship of this to distributional issues.

6. For more extensive treatments of the classical view, see O'Brien 1975, Robbins 1952, and Samuels 1966. A more broad-based overview of fiscal theory can be found in Musgrave 1985.

understood that the market could only operate satisfactorily—harmonizing actions of self-interested agents with the interests of society as a whole—within a framework of legal, political, and moral measures that facilitated certain forms of action while restricting others. Yes, there is a hostility to government that is evidenced in varying degrees throughout classical economics, largely a legacy of Smith's harsh critique of mercantilism—a critique that continued pretty much unabated in the nineteenth century. But on the whole, classical political economy evidences a relatively pragmatic view of the economic role of government. Witness J. R. McCulloch's contention that "the principle of *laisser-faire* may be safely trusted to do in some things but in many more it is wholly inapplicable; and to appeal to it on all occasions savours more of the policy of a parrot than of a statesman or a philosopher" (quoted in Robbins 1952, 43). Elsewhere, McCulloch notes, in a similar vein, that "the question is not whether any regulation interferes with the freedom of industry, but whether its operation is on the whole advantageous or otherwise" (quoted in O'Brien 1975, 272–73). Likewise, Nassau Senior argued that "the only rational foundation of government, the only foundation of a right to govern and a correlative duty to obey is, expediency—the general benefit of the community. It is the duty of a government to do whatever is conducive to the welfare of the governed" (quoted in Robbins 1952, 45). And, at the end of the classical period, we have J. E. Cairnes's assertion that "'the maxim of *laissez-faire* . . . has no scientific basis whatever'; it is a 'mere handy rule of practice,' though 'a rule in the main sound'" (Sidgwick [1885] 1904, 180).[7]

The point to be taken here is that, far from being antigovernment apologists for the business class, the classical economists were concerned with what set of policies would promote society's best interests and were vociferously opposed to policies—like those of mercantilism, but also many others—that they believed served the interests of particular groups at the expense of the larger population. In particular, their consumption-oriented view led them to the belief that freedom of choice was desirable for consumers, and that freedom for producers was the most effective means of satisfying these consumer desires. It was thought that the impersonal forces of the market, working through the system of natural liberty, would then serve to harmonize these interests—or at least would

7. It is worth pointing out that the utilitarian wing of classicism, which includes Bentham and James Mill in the early part of the nineteenth century, was somewhat more overtly and self-consciously interventionist than the rest of classicism during that period.

do so to a greater and more beneficial extent than would other systems—and that the most basic function of government was the establishment and enforcement of a system of law that would control, channel, and restrain certain aspects of individual action, and liberate and facilitate others, in such manner that the individual pursuit of self-interest would lead to the greatest happiness.[8] That is, the classical period saw the transformation of self-interest from something base whose effects should be negated by a wide-ranging program of governmental restrictions to a view of self-interest as a driving force toward increased economic welfare for all when channeled through the competitive market process[9]—most famously evidenced in Smith's ([1776] 1976, 423) statement that "by pursuing his own interest [an economic agent] frequently promotes that of the society more effectually than when he really intends to promote it." Even a problem as seemingly severe as the population problem is kept in check, in Malthus's (1798) system, by the operation of the forces of self-interest.

This presumption in favor of private enterprise in English classical political economy does not derive simply, or perhaps even primarily, from a positive view of the system of natural liberty, or from the sort of "shallow optimism," as Sidgwick puts it, that one sees in Frédéric Bastiat and his followers. Rather, the classical predisposition against interference is rooted in pessimism—"a conviction that however bad things might be naturally, direct interference by Government could only make them worse" (Sidgwick [1885] 1904, 181–82). This perspective is amply evidenced in Smith's strident criticisms of government agents and of governmental attempts to channel resources in directions they would not naturally flow, and this attitude was carried through a century of classical political economy.

How, then, did the tide begin to turn?

John Stuart Mill, Individual Liberty, and the Problem of External Effects

John Stuart Mill's perspective is emblematic of a continuity within the classical tradition reaching back to Smith but at the same time marks a

8. This led Robbins (1952, 56) to suggest that Smith's "invisible hand" is actually government itself: it "is not the hand of some god or some natural agency independent of human effort; it is the hand of the law-giver, the hand which withdraws from the sphere of the pursuit of self-interest those possibilities which do not harmonize with the public good."

9. This competitive market process was not independent of government in that, as Smith and others emphasized, legal institutions are necessary components of the market structure.

transition toward an increasing recognition of market failures that became a centerpiece of the Cambridge school's welfare economics. The seriousness of the issue of the appropriate role for the state, both within the economic sphere and without, and the contentious nature of the debate on this topic is, for Mill, both reflected in and a result of the fact that

> there is . . . no recognized principle by which the propriety or impropriety of government interference is customarily tested. People decide according to their personal preferences. Some, whenever they see any good to be done, or evil to be remedied, would willingly instigate the government to undertake the business; while others prefer to bear almost any amount of social evil, rather than add one to the departments of human interests amenable to governmental control. (Mill [1859] 1992, 20–21; see also [1848] 1909, 795–96, 941–42)

The absence of a generally accepted rule or principle for assessing the usefulness of government action, says Mill, means that both sides are often wrong in their assessments—"the interference of government is, with about equal frequency, improperly invoked and improperly condemned" ([1859] 1992, 21).

Mill believed it absolutely necessary to have in place a framework for assessing the propriety of government interference;[10] the elaboration of such was his goal in writing *On Liberty* (1859), and it is also the subject of book 5 of his *Principles*.[11] Mill ([1859] 1992, 14) contends that there is "a limit to the legitimate interference of the collective opinion with individual independence"; moreover, "to find that limit, and maintain it against encroachment, is as indispensable to a good condition of human affairs as protection against political despotism."[12] For Mill, the appropriate rule or limit is not arbitrary—there *exists* a limit to what is legitimate, and it is something to be *discovered*, not something to be worked out via the utilitarian calculus. And Mill ([1848] 1909, 943) is very explicit in setting out exactly what this limit is: "There is," he says, "a circle around every human being which no government . . . ought to be permitted to overstep," and, for him, this circle "ought to include all that part which

10. Mill uses the terms *interference* and *intervention* interchangeably in his *Principles*.

11. Mill's *Principles* was originally published in 1848, but his treatment of the present subject is remarkably consistent across editions. All references herein are to "Ashley" version of the seventh edition, which was published in 1909.

12. This concern about impingements on individual independence can also be found in Mill's writings on socialism—a system that he says will probably significantly exacerbate this "great growing evil" ([1879] 1967, 746)—and in his *Principles* ([1848] 1909, 942–43).

concerns only the life, whether inward or outward, of the individual, and does not affect the interests of others, or affects them only through the moral influence of example."[13] For government to intervene for a person's own good, "either physical or moral," does not fall within these limits ([1859] 1992, 22). Mill is clearly arguing here for freedom of individual action where externalities are absent. Where externalities do exist, however, the situation is altered: "Whenever . . . there is a definite damage, or a definite risk of damage, either to an individual or to the public, the case is taken out of the province of liberty, and placed in that of morality or law" ([1859] 1992, 147; see also [1848] 1909, 943). Looking at this principle from the perspective of the individual's obligation, "the liberty of the individual must be thus far limited; he must not make himself a nuisance to other people" ([1859] 1992, 101). And, as Mill ([1848] 1909, 943) points out in both the *Principles* and *On Liberty*, in those instances where the individual does not exercise sufficient forbearance to accomplish this, a potential role for the state arises.[14]

Mill's view of the matter is depicted graphically in figure 1. Here, there are two parties, A and B, each with their respective set of interests. Mill recognizes that A and B do not exist in isolation; in the intersection of these sets—the cross-hatched area—their interests are in conflict. For Mill, any portion of the \\\ shaded area within A is inviolable: there are no spillovers onto B from actions within this area, and hence no legitimate grounds for state interference with A's liberty. In the cross-hatched area—where there are spillovers or collisions of interests between A and B—the situation changes. The protections afforded to individual liberty disappear and allow for the potential exercise of government interference with individual action.[15]

Mill ([1859] 1992, 169) is cognizant of the ubiquity of these external effects, in the sense that a gain for A sometimes (even often) implies a loss for B:

13. The same perspective can be found in *On Liberty*, where Mill ([1859] 1992, 21–22) argues that "the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others." Mill says that "the object of" *On Liberty* is to assert this "one very simple principle" (21).

14. Mill is not asserting this as a hypothesis to be examined and tested; rather, he says, it is an "indispensable" principle ([1859] 1992, 134).

15. Note that Mill fails to appreciate the reciprocal nature of the spillover issue (that one cannot label A or B as *the* cause of the harm)—a point made forcefully by Ronald Coase (1960) a century later.

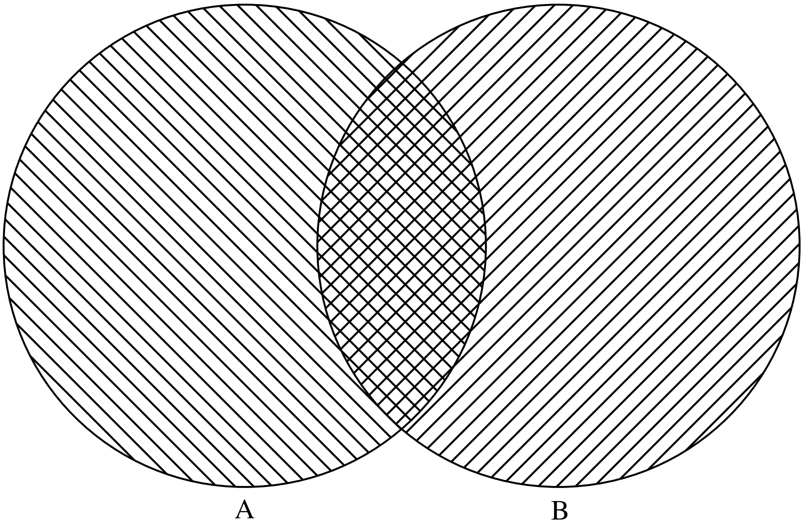

Figure 1 The intersection of A and B represents the area of conflict between the interests of A and B—the area where Mill says there is at least a potential for the exercise of government interference with individual action

> In many cases, an individual, in pursuing a legitimate object, necessarily, and therefore legitimately causes pain or loss to others, or intercepts a good which they had a reasonable hope of obtaining. Such oppositions of interest between individuals often arise from bad social institutions, but are unavoidable while those institutions last; and some would be unavoidable under any institutions.

The issue, then, is not one of eliminating these spillovers, for that is impossible. The problem is one of determining how society should deal with these spillover effects in their various manifestations.

There is an extremely important asymmetry in Mill's prescription here. While Mill offers severe strictures against violations of individual liberty in the *absence* of externalities, he does not turn around and argue *for* intervention in those situations where externalities *are* present: "It must by no means be supposed," he says, "because damage, or probability of damage, to the interests of others, can alone justify the interference of society, that therefore it always does justify such interference" (169). In terms of figure 1, then, the mere existence of a conflict between A's and B's respective interests—the cross-hatched area where the two circles overlap—is not in itself sufficient to justify government intervention, even though the lack of such conflict is sufficient to rule it out.

It is here that we see Mill's utilitarian side coming to the fore, with implications for those on *both* sides of the debate over the limits of state action. Mill ([1848] 1909, 941) brings in for criticism both "supporters of interference . . . content with asserting a general right and duty on the part of government to intervene, whenever its intervention would be useful" and "the *laisser-faire* school," which would restrict the operation of government to "the protection of person and property against force and fraud." For Mill, such trite offerings do not work simply because the issue of the appropriate boundaries for government action "does not . . . admit of any universal solution" (941–42). Indeed, even where government intervention may be warranted, the appropriate *form* of such action will vary, depending on the nature of the market failure. Mill distinguishes between two forms of government action: the authoritative, in which certain types of conduct are prescribed or proscribed, and the nonauthoritative, where government provides, for example, advice, information, services, and institutions, which are thereby available to the citizenry but do not impinge upon freedom of choice and action. Because prescription and proscription *do* limit individual freedom, Mill argues that they have "a much more limited sphere of legitimate action" and require "a much stronger necessity"—specifically, the harmful spillover effects—to justify them (942).

Where, then, does Mill wish to draw the line between acceptable and nonacceptable government interference in the presence of spillovers? The pragmatic nature of nineteenth-century classicism, most amply evidenced in its utilitarian strain, comes out here perhaps more strongly and explicitly in Mill than in any of his predecessors or contemporaries. The criterion for the boundaries of the appropriate functions of government, he contends, is not strict or a priori; rather, it is grounded in "expediency":

> The admitted functions of government embrace a much wider field than can easily be included within the ring-fence of any restrictive definition, and . . . it is hardly possible to find any ground of justification common to them all, except the comprehensive one of general expediency; nor to limit the interference of government by any universal rule, save the simple and vague one, that it should never be admitted but when the case of expediency is strong. (800)

A simple suggestion, an assertion, or a bit of evidence that government intervention can improve the situation, then, is not sufficient, in Mill's mind; the case must be a "strong" one.[16]

The "necessary" functions of government, where the case for expediency is obvious, are, for Mill, much broader than simplistic discussions might indicate. Indeed, he says, those who suggest that the functions of government should be limited to "protection against force and fraud" are espousing "a definition to which neither they nor any one else can deliberately adhere, since it excludes . . . some of the most indispensable and unanimously recognized duties of government" (941). In addition, of course, to duties such as national defense and the provision of protective justice, they range over laws governing the many facets of inheritance, property, and contracts; the protection of those unable to look after themselves; the coining of money; the establishment of a standard set of weights and measures; the paving, lighting, and cleaning of roadways; the provision and improvement of harbors and lighthouses;[17] the making of surveys in order to have accurate maps and charts; and the construction of dykes and embankments. Moreover, Mill takes pains to show that the application of government to many of these generally accepted tasks is not necessarily as circumscribed as some allege. Even things supposedly as simple as the "enforcement" of property and contract are, in fact, quite extensive and open-ended in nature. In the case of property,

> it may be imagined, perhaps, that the law has only to declare and protect the right of every one to what he himself has produced, or acquired by the voluntary consent, fairly obtained, of those who produced it. But is there nothing recognized as property except what has been produced? Is there not the earth itself, its forests and waters, and all other riches, above and below the surface? These are the inheritance of the human race, and there must be regulations for the common enjoyment of it. What rights, and under what conditions, a person shall be allowed

16. We shall return to the rationale behind the "strong" qualifier below.

One class of spillovers that Mill rules out of bounds for government on expediency grounds are those that naturally and inevitably occur within the context of a competitive market system. Life, according to Mill, is often a zero-sum game, as in, for example, when A gets the job and B does not. But, he says, society correctly "admits no right, either legal or moral, in the disappointed competitors, to immunity from this kind of suffering; and feels called on to interfere, only when means of success have been employed which it is contrary to the general interest to permit—namely, fraud or treachery, and force" ([1859] 1992, 169–70).

17. On the lighthouse example, see note 30, below.

> to exercise over any portion of this common inheritance cannot be left undecided. No function of government is less optional than the regulation of these things, or more completely involved in the idea of civilized society. (797)

The situation with contracts is quite similar. Mill says that, in actuality, "governments do not limit their concern . . . to a simple enforcement" of that which is the product of voluntary consent. Rather, they "take upon themselves to determine what contracts are fit to be enforced" (798). What Mill is offering here is at least as much a philosophical discussion of the law-making function of government as it is a normative discussion of appropriate tasks for the state. That is, once one admits of the need for government enforcement of property and contract, the range of activities necessarily opened up to government action, Mill says, is very extensive.

There is another set of problems with self-interested action, though, where the remedy is somewhat less obvious. These are cases where individuals may well not be the best judges of their own interests, and this may have consequences for others, including for society as a whole. In his *Principles*, Mill gives several examples. First, people are not always the best judges regarding education, whether for themselves or their children, and Mill makes both the individual and the positive externality arguments in support of some degree of public provision of education. Second, limited foresight sometimes causes people to enter into contractual arrangements that bind them for longer periods than they might otherwise agree to, and such contracts—especially perpetuities—should not be enforced in all cases. Third, monopoly power attends the provision of certain public utilities, and government regulation or management may thus be necessary in the public interest. Fourth, strategic considerations may prevent individuals or firms from taking actions that might work to the great benefit of society, unless government enforces that behavior upon all participants in the market. Mill cites as an illustration the problem of labor shortages for producing goods and services and building infrastructure in the new world because of the rush to acquire landholdings. The issue, Mill says, is that

> however beneficial it might be to the colony in the aggregate, and to each individual composing it, . . . no one should occupy more land than he can properly cultivate, nor become a proprietor until there are other laborers ready to take his place in working for hire; it can never be in the interest of an individual to exercise this forbearance, unless he is

> assured that others will do so too. Surrounded by settlers who have each their thousand acres, how is he benefited by restricting himself to fifty? Or what does a labourer gain by deferring the acquisition altogether for a few years, if all other labourers rush to convert their first earnings into estates in the wilderness a few miles apart from one another? (966)

His forbearance does nothing to remedy the shortage of laborers and will leave him in a position inferior to that of his fellows. Thus, says Mill, "it is in the interest of each to do what is good for all, but only if others will do likewise" (966).[18] Fifth, public charity is likely to be insufficient if left to private means. Sixth, colonization offers various benefits to the nation, including lowering population pressures by spreading people to (relatively) unoccupied parts of the world, but it may not repay individual interests to undertake all of the necessary start-up costs. The same, he says, may be true of the development of certain infant industries (922). Seventh, the resources devoted to the discovery of new knowledge via geographic and scientific exploration and the maintenance of a learned class are likely to be insufficient if these matters are left to individual action.

Mill finds these failings sufficiently significant that the "presumption in favour of the competition of the market does not apply" to them. But, he says, this does not mean that government intervention is the answer, either. Mill is prepared only to say that, in these instances, "the balance of the advantages *may* be in favour of some mode and degree of intervention by the authorized representatives of the collective interest of the state" (953; emphasis added). In most of the above-mentioned cases, Mill's preference—if there indeed is to be government intervention—is for "non-authoritative" actions. Government, he argues, should not monopolize activities such as education, public charity, colonization, scientific exploration, and the maintenance of a learned class, simply because they will not be provided in sufficient amounts through voluntary mechanisms.[19] The utility of state action does not mean that society could not benefit

18. A suggested remedy was to limit land ownership until one had worked a number of years as a laborer. Mill also cites the example of reductions in work hours, which no individual firm has the incentive to undertake, knowing that others will not match their action.

19. The reader may notice a terminological tension here between the negative consequences of self-interested action and the notions of "negative" and "positive" externalities. It bears emphasizing that the limitations of natural liberty—market failures, if you will—pointed to by Mill (and, as we shall see, by Sidgwick) fall into both negative-externality and positive-externality (including public goods) categories. In both cases, however, these problems derive from *negative* aspects of self-interested behavior. Thus, for example, the free-rider problem is a "negative" force giving rise to the underprovision of goods with "positive" external effects.

from the presence of private alternatives or supplements to the government-sponsored activities.

What remains to be explained is why a utilitarian like Mill would argue that simple expediency is not sufficient to trigger state intervention. Why, that is, must the case for expediency be strong? We have seen that Mill suggested an extensive list of divergences between private and social interests, and this seems to contradict George Stigler's (1965, 6 n. 9) contention that Mill's position is grounded in the beneficial effects of individual liberty. We thus need to explain why this wide range of market failures does not, for Mill, give rise to an equally wide range of appropriate government interventions. The answer, I maintain, lies in the limitations of the state, whose management Mill ([1848] 1909, 960) characterizes as "proverbially jobbing, careless, and ineffective."[20] In spite of his relatively extensive elaboration of legitimate governmental functions, Mill contends that government is poorly organized to carry out many of the tasks that people would wish it to undertake, and that, even if it were well organized, the related information issues and incentives are such as to make private efforts superior to governmental ones in carrying out many tasks (945–47). Moreover, he suggests that the expansion of government—such as to deal with a wider range of market failings—will only serve to exacerbate these problems.

Some of the reasons underlying Mill's position are spelled out in works that more overtly tackle the functioning of government, including *Considerations on Representative Government* (1861), *On Liberty* (1859), and his essay dealing with "centralisation" (1862).[21] For example, Mill ([1861] 1977, 436) sees government as afflicted by "general ignorance and incapacity, or, to speak more moderately, insufficient mental qualifications, in the controlling body." This, in turn, is at least in part a result of his view that government jobs do not "hold out sufficient prospects of emolument and importance to attract the highest talents" ([1859] 1992, 199). Mill certainly does not see democracy as any sort of panacea: "The natural tendency of representative government, as of modern civilization," he says, "is towards collective mediocrity" ([1861] 1977, 457).[22] The result is "the

20. *Jobbing*: "The action of using a public office or service for private gain or party advantage" (*OED*).

21. Mill's dim view of the operation of government is also evidenced in his chapters on socialism ([1879] 1967, esp. pp. 739–42).

22. Likewise, in *On Liberty*, Mill ([1859] 1992, 118) says that "the general tendency of things throughout the world is to render mediocrity the ascendant power among mankind." Mill ([1861] 1977, 457) lays part of this on the extension of the franchise.

government of mediocrity," which leads to nothing more than "mediocre government" ([1859] 1992, 118). That having been said, Mill is not keen on having the best and the brightest filling governmental positions either. Given their limited numbers, utilizing a large share of these individuals in government posts would virtually eliminate the important outside check on government that they could provide. Moreover, Mill suggests that even the best and the brightest are not immune from the pressures of interests that diverge from those of the larger community, nor from bribery and other forms of corruption that can come with such pressures. In the end, then, government by the brightest would not necessarily, he says, be superior to "government by the mediocre."[23]

Mill's conclusions about the prospects for effective government intervention in all but the most obvious situations are thus quite pessimistic—at least as regards more or less democratic forms of government: "No government by democracy or a numerous aristocracy," he says, "either in its political acts or in the opinions, qualities, and tone of mind which it fosters, ever did or could rise above mediocrity" ([1859] 1992, 119).[24] It is because of this pessimism about the ability of government intervention to make matters better rather than worse—a perspective that one finds across his writings—rather than because of a faith in the system of natural liberty, that we find Mill ([1848] 1909, 950) arguing that a society should restrict "to the narrowest compass the intervention of a public authority in the business of the community." Mill set himself apart from his classical forebears in his assessment of the limits of the system of natural liberty, but he demonstrated an important continuity with them in his insistence that the burden of proof should fall "on those who recommend, government interference" (950). The summary version of Mill's view of the matter is unmistakable in its message: "*Laisser-faire*, in short, should be the general practice: every departure from it, unless required by some great good, is a certain evil" (950).

Henry Sidgwick and the Dismantling of the System of Natural Liberty

Mill's forays into the realm of externality-related problems with the system of natural liberty and the effects of self-interested behavior received

23. See, e.g., Mill [1859] 1992, 202; [1861] 1977, 436, 441, 444–45; [1862] 1977, 607–8.

24. Mill continues by saying that to rise above mediocrity requires following the lead of "One or Few" possessed of great wisdom (119).

further development at the hands of Henry Sidgwick. Sidgwick considered self-interest a centerpiece of human motivation, noting in his *Principles of Political Economy* that "the motive of self-interest does work powerfully and continually" ([1883] 1901, 402). Because of this, he was a vociferous defender of economists' use of the assumption of self-interested action by economic agents. While he went to some lengths to rebuff the critics who suggested that promoting self-interested action was a *normative goal* of English political economy, he also maintained that self-interested action—for instance, in the way of attempting to sell for the highest price the market will bear or attempting to buy at the lowest possible price—is not "blameworthy" ([1885] 1904, 183). In fact, he was very much aware of its utility in the economic sphere, to the point where "the difficulty of finding any adequate substitute for it, either as an impulsive or as a regulating force, is an almost invincible obstacle in the way of reconstructing society on any but its present individualistic basis" ([1883] 1901, 402).

Even so, Sidgwick does not find the results of the operation of self-interest to be an unmitigated good, nor does he find any basis for claims of such in classical political economy—at least that of the nonvulgar variety. However, he was well aware that extreme laissez-faire views were in the air:

> There is indeed a kind of political economy which flourishes in proud independence of facts; and undertakes to settle all practical problems of Governmental interference or private philanthropy by simple deduction from one or two general assumptions—of which the chief is the assumption of the universally beneficent and harmonious operation of self-interest well let alone. ([1885] 1904, 171)

Sidgwick had little use for this brand of political economy, suggesting that it should be "banished to the remotest available planet" as soon as possible (171).

Sidgwick is quick to point out, though, that the roots of this vulgarity are not to be found in Smith, whose "advocacy of natural liberty in no way binds him to the perpetual and complex opposition and conflict of economic interests involved in the unfettered efforts of individuals to get rich" (172).[25] He does, however, lay some of the responsibility at the

25. Indeed, Sidgwick says that to suggest Smith proffers "a dogmatic theory of the natural right of the individual to absolute industrial independence . . . is to construct the history of economic doctrines from one's inner consciousness" (173).

feet of Ricardo and his "more abstract and purely deductive method" (173), a method in many ways at odds with what Sidgwick considered his own more empirically oriented approach (about which more below).

While Sidgwick believes that self-interest has tremendous utility in the economic sphere, he does not believe that the system of natural liberty functions optimally in all times and places. Even if one grants that individuals *are* the best judges of their own interests, he says, "it by no means follows that an aggregate of persons seeking each his private interest intelligently, with the least possible restraint, is therefore certain to realise the greatest attainable happiness for the aggregate" ([1891] 1897, 144–45). Sidgwick identifies two general categories of divergence between private and social interests: those where laissez-faire's wealth-maximizing results are not in society's best interest because there is more to life than wealth, and those where laissez-faire does not even generate the wealth-maximizing result.

In the former case, he observes that "the universal practice of modern civilized societies has admitted numerous exceptions to the broad rule of *laisser-faire*" ([1886] 1904, 202). For Sidgwick, these exceptions include (1) the protection of those who cannot see to their own self-interest, such as the mentally infirm and children, with the result that we have, for example, regulations regarding children's education and employment (see also Sidgwick [1883] 1901, 425); (2) measures that deal with issues of physical or moral well-being, such as "sanitary regulations, restrictions on the sale of opium, brandy, and other intoxicants; prohibitions of lotteries, regulation of places of amusement; and similar measures" ([1886] 1904, 203); and (3) policies designed to rectify problems with the distribution of income (202–5) (see Backhouse 2006).

Sidgwick also points to a number of situations where laissez-faire is *not* wealth-maximizing. The problem, he argues, is that the underlying conditions necessary for the system of natural liberty to work the wealth-maximizing magic so often attributed to it do not correspond, in many instances, to actual economic circumstances. The result is that "even in a society composed—solely or mainly—of 'economic men,' the system of natural liberty would have, in certain respects and under certain conditions, no tendency to realise the beneficent results claimed for it" ([1883] 1901, 402–3). For example, one party's actions may well interfere with the freedom of other parties—such as in the realm of property, where "use" can often give rise to negative spillover effects. Freedom of contract, too, may result in harmful effects to third parties—individuals or society as a whole—and may also violate other existing laws, or even lead to voluntary slavery, which, he argues, is not in society's economic best interests ([1891] 1897, 90; [1883] 1901, 405–6). Problems also arise owing to monopoly, where Sidgwick's concern is not just that monopoly reduces output and increases price, as against a competitive market, but also that the monopolist, by virtue of his privileged position, may not have any incentive to invest in the development of more economical production techniques.

One particularly prominent and instructive set of examples Sidgwick cites to illustrate the divergence between private and social interests deals with the use of natural resources, including the potential depletion of mines, fisheries, and plant species, and the diversion of waterways necessary for irrigation and "the supply of motive power" ([1891] 1897, 147; [1883] 1901, 409–13). He begins by pointing out that in a "*perfectly ideal* community of economic men all the persons concerned would doubtless voluntarily agree to take the measures required to ward off such common dangers."[26] In reality, however, "the efforts and sacrifices of a great majority are liable to be rendered almost useless by the neglect of one or two individuals" ([1883] 1901, 409–10; emphasis added)—a problem he illustrates by applying the then-emerging marginal analysis to the common-pool fisheries problem:

> Take, for instance, the case of certain fisheries, where it is clearly for the general interest that the fish should not be caught at certain times, or in certain places, or with certain instruments, because the increase of actual supply obtained by such captures is much overbalanced by the detriment it causes to the prospective supply. Here—however clear the common interest might be—it would be palpably rash to trust to voluntary association for the observance of the required rules of abstinence; since the larger the number that thus voluntarily abstain, the stronger becomes the inducement offered to those who remain outside the association to pursue their fishing in the objectionable times, places, and ways, so long as they are not prevented by legal coercion. (410)

This issue of "overusing" natural resources is one facet of two larger issues that Sidgwick sees as potentially serious sources of problems with laissez-faire.[27]

26. See also Sidgwick [1886] 1904, 207. The parallel to Coase 1960 should not be lost on the reader.

27. The reader will note that there are commonalities between this analysis by Sidgwick and Mill's discussion of the over-ownership, as it were, of lands during the colonization process, discussed above.

The first of these problems is the failure to properly account for the interests and needs of future generations because self-interested economic agents do not take account of the full social impact—positive or negative—of their activities ([1883] 1901, 412–13, 475–76),[28] something previously noted by Mill.[29] For example, a project involving a large present outlay but with benefits (in excess of costs) that accrue only in the distant future may not be undertaken because those who wish to undertake the project lack sufficient capital, while those possessing such capital would refuse to lend or invest because they could not themselves appropriate a sufficient share of the resulting long-term gain. A similar line of reasoning applies to parents, some of whom are unable to see what is in the long-run best interests of their children and thus will be inclined to underinvest in their education.

A second problem highlighted by the common-pool example is the "incentive to cheat," which can manifest itself in a variety of ways in the context of voluntary association, including the overuse problem and the free-rider problem. The power of this incentive is sufficiently large that "it would be dangerous to trust" voluntary agreement or association for the accomplishment of functions of public importance, whether of a traditional public goods variety or more nontraditional (but no less important) tasks such as flood protection for low-lying areas and the protection of "useful animals and plants" against disease ([1891] 1897, 150).

Sidgwick also describes a number of instances in which private enterprise will not provide goods and services in the necessary amounts because of the inability to appropriate sufficient returns to justify the investment. The provision of lighthouses, forests (with "their beneficial effects in moderating and equalising rainfall"), worker training, scientific discoveries, and inventions ([1883] 1901, 406; [1891] 1897, 148)—some of which had been noted by Mill[30]—is one such class of activities.

28. Sidgwick repeatedly emphasizes that the scope of the general happiness, good, or welfare encompasses the interests of both present and future generations, and he also argues that this interpretation is held by "the great majority of persons" ([1891] 1897, 38).

29. The general issue was recognized by Mill in his *Principles* and in his defense of the religion of humanity ([1865] 1969), but received a far more detailed and analytical treatment, and was ascribed a significantly more expansive domain, in Sidgwick's discussion.

30. We see here, as in Mill, a mention of the lighthouse as a good that cannot be provided through the private sector. The empirical validity of this assertion was challenged by Ronald Coase (1974), whose argument was, in turn, clarified to some extent by David Van Zandt (1993). See also Medema 1994, chap. 5; and O'Brien 1998, 31–33. Richard Musgrave (1985, 2–15) provides a useful overview of the history of public goods theory.

A similar line of reasoning underlies Sidgwick's defense of and expansion upon Mill's case for temporary infant-industry protection: long-run gains may exist from the development of domestic industry, but short-run competitive disadvantage leaves private interests unwilling to enter without some form of protection ([1883] 1901, 488–91).

What, then, are the implications of all of this for the role of the state within the economic system? One approach, and the one much in evidence in the classical literature, is the laissez-faire approach, which Sidgwick ([1891] 1897, 137 n) defines as "the rule of 'letting people manage their affairs in their own way, so long as they do not cause mischief to others without the consent of those others.'" Here, the limits of government activity involve satisfying the "individualistic minimum," which consists of security of person, property, and contract, and ensuring noninterference among persons absent compensation (42, 79).

This individualistic minimum contrasts with what Sidgwick refers to as "socialistic" interference. Not to be confused with social*ism* or collectivism, this interference consists simply of "any limitation on the freedom of action of individuals in the interest of the community at large, that is not required to prevent interference with other individuals, or for the protection of the community against the aggression of foreigners" (42–43). These actions have the effect of narrowing "the sphere of private property and private enterprise, by the retention of resources and functions in the hands—or under the regulation—of Government as representing the community" (153).

As Sidgwick goes to some lengths to point out, teasing out the meaning of and content that society should give to these categories is no mean feat. For example, while arguing that infliction of avoidable damage on another party presents a prima facie case for government enforcement of compensation, Sidgwick recognizes the difficulty of making such judgments owing to the reciprocal nature of these external effects: preventing harm to one party restricts the freedom of action of another party. Not surprisingly, given his utilitarian approach to these issues, Sidgwick contends that the extent to which one party should be free from interference of the other "can only be settled in any particular case by a careful balance of *conflicting inconveniences*" (69; emphasis added).[31]

31. Once again, the commonality with Coase 1960 is worth noting. These remedies, Sidgwick ([1891] 1897, 110) says, should be sufficient both to fully compensate for harm done and to prevent these harms in the future.

Sidgwick's concerns about the less-than-clear-cut nature of the individualistic-socialistic distinction can be further illustrated by examining the issue of fraud prevention—a task that, as he points out, clearly seems to fit within the individualistic minimum. On the one hand, society has any number of fraud prevention rules in place:

> To prevent the flesh of diseased animals from being disguised as the flesh of healthy animals; to prevent would-be surgeons or apothecaries from pretending to have obtained certificates of qualification which they have not really obtained; to oblige employers who may have contracted to pay wages in goods to supply such goods in strict accordance with contract as regards quality and price. (135)

And, he says, "all this is clearly and directly individualistic" (135). Yet, he continues, there are forms of fraud prevention that would be seen as violations of the individualistic minimum—such as if the government "absolutely prohibits the purchase of food it deems unhealthy, the consultation of physicians it deems unqualified, the adoption of methods of payment it deems unfit." In these cases, Sidgwick argues, the state's actions fall squarely within the realm of the "paternal" (135).

There are, however, other alternatives for dealing with these types of information problems—ones in which, as Sidgwick notes, government can take steps that will prevent deception without incurring charges of paternalistic interference: "It may take measures to remove the ignorance of consumers as to the dangerous qualities of commodities offered for purchase,—or the ignorance of labourers as to the dangerous nature of instruments which their employers require them to use,—without compelling any one to act on the information thus supplied" (136). This, of course, parallels Mill's category of nonauthoritative interference, discussed above. Whether the government's actions are considered to be individualistic or socialistic thus comes down to the method that it employs in its attempt to prevent the harm. By employing "measures to remove . . . ignorance," the government fulfills the task of protecting individuals from harm caused by the actions of others, but still allows these individuals to assume the relevant risks if they so choose. Prohibitions, by way of contrast, involve the government's making people's choices for them. For example, by restricting the depletion of natural resources, government fulfills its duty of "representing the community [present and future] to prevent the bounties of nature from being wasted by the unrestricted pursuit of private interest" (147; see also [1883] 1901, 475–76). The determination of the extent and limits of this, including of the scope of private versus common property, is "a matter which has to be settled by the aid of special experience on a balance of conflicting considerations" ([1891] 1897, 77).

It is "an anachronism," says Sidgwick ([1885] 1904, 175), "to not recognize fully and frankly the existence of cases in which the industrial intervention of Government is desirable, even with a view to the most economical production of wealth."[32] But the fact that market outcomes are not always wealth-maximizing or otherwise in society's best interests does not mean, for Sidgwick, that government intervention is the best course of action. "In human affairs," he says, "we have often only a choice of evils, and even where private industry fails to bring about a satisfactory result, it is possible that governmental interference might on the whole make matters worse" ([1886] 1904, 206).[33] In support of this, Sidgwick ([1883] 1901, 414–15; [1891] 1897, 167–68) points to several "drawbacks and disadvantages" associated with government intervention: (1) government using its power for corrupt purposes; (2) the desire to please special interest groups; (3) "wasteful expenditure under the influence of popular sentiment" that arises because "the mass of a people, however impatient of taxation, are liable to be insufficiently conscious of the importance of thrift in all the details of national expenditure"; (4) the supervisory problems with the expansion of the range of government activities; (5) the cost of the taxes associated with these operations of government; and (6) the lack of incentives for government workers to properly carry out the functions assigned to them. Sidgwick argues that these "costs" must be weighed against the benefits to determine the appropriateness of government intervention, and, even when intervention *is* in the public interest, this interference should, he says, be as mild and as narrowly drawn as possible while still accomplishing its set goal.

32. Sidgwick argues that the shortcomings of private enterprise justify government interference with the provision of goods that he categorizes under the heading "machinery of transfer" (things that facilitate transactions and exchange). Here, Sidgwick makes a more sophisticated case than that extant in the literature for governmental provision of traditional public works including roads, canals and railways, telegraph and postal services, and light and water, as well as the provision of currency, banking, and insurance services for the poor, and the collection and dissemination of statistical information. Not only is government, according to Sidgwick ([1883] 1901, 438–39), "peculiarly adapted to provide" these services; in doing so, it becomes the *facilitator* of commerce and the market rather than an impediment to it.

33. Sidgwick ([1883] 1901, 414) expresses a similar sentiment in his *Principles*: "It does not of course follow that wherever *laisser faire* falls short governmental interference is expedient; since the inevitable drawbacks and disadvantages of the latter may, in any particular case, be worse than the shortcomings of private enterprise."

Even with these drawbacks, however, Sidgwick ([1883] 1901, 414) believes that the extent of the failure of public and social interests to coincide is such that we need to "regard governmental interference as not merely a temporary resource, but not improbably a normal element of the organisation of industry." In these cases, "the general economic presumption in favor of leaving social needs to be supplied by private enterprise is absent, or is balanced by strictly economic considerations on the opposite side" ([1886] 1904, 206). But reflecting Sidgwick's view that self-interest channeled through markets is the best single system society has yet been able to devise, he goes on to point out that this interference "is here only recommended as a supplementary and subordinate element" ([1891] 1897, 146).[34]

In spite of the various negative attributes of state action identified by Sidgwick, he does not share the degree of pessimism exhibited by Mill and the larger classical tradition toward the possibilities of government intervention. In fact, Sidgwick ([1883] 1901, 416) suggests that in the long run "moral and political progress [in society] may be expected to *diminish*" the extent and severity of the shortcomings associated with government intervention (emphasis added). This, in turn, will increase over time the range of activities that government can carry out in a manner superior to market forces. This long-run optimism is most strikingly expressed in his assessment of socialism. While of the mind that collectivism would, at the time of his writing in the late nineteenth century, "arrest industrial progress" and bring about "equality in poverty," he saw something potentially quite different for the future:

> It is, I think, quite conceivable that, through improvements in the organization and working of governmental departments, aided by watchful and intelligent public criticism—together with a rise in the general level of public spirit throughout society—the results of the comparison [between individualism and collectivism] will at some future time be more favourable to governmental management than they have hitherto been. ([1891] 1897, 159)

34. A further issue that arises is that, in many cases, the "*economic* considerations" at stake are inconsequential. As a result, "the final decision" as to the expediency of many regulations "does not fall within the sphere of political economy and cannot be arrived at by strictly economic methods" because "life and health are goods which it is not possible to estimate at a definite pecuniary value" ([1883] 1901, 424). Interestingly, though, Sidgwick does allow that "all reasonable persons would admit that at a certain point the machinery for saving even life and health may become too costly," and thus "the practical necessity of balancing these goods in some way against wealth cannot be evaded" (424 n. 1).

The question of the accuracy of this prognostication is less important for present purposes than its contrast with the classical view and its influence on the Cambridge welfare tradition, as evidenced by its repetition in the writings of Alfred Marshall ([1907] 1925, 336; 1926, 395) and A. C. Pigou (1912, 250; 1932, 333–35).[35]

Utilitarianism, Optimism, and the Flight from Natural Liberty

In Mill we see continuity with the classical tradition in his discussion of the state and, especially, his dim view of the prospects for government intervention.[36] However, we see a major break from the classical system in his expansive view of the failings of the system of natural liberty. In the transition from Mill to Sidgwick, we have added to this a major shift in the view of the state away from the classical perspective. Via this two-stage process, then, we arrive, by the late nineteenth century, with a view of the respective efficacies of natural liberty and the state that is in some sense 180 degrees opposed to the perspective that was dominant during the classical period.[37]

Mill's theory of market failure and accompanying view of the role of the state is heavily grounded in his utilitarianism. This allows him to move the debate beyond the handy, rule-of-thumb pragmatism to a grounded criterion for government intervention. That having been said, his is not a full-blown utilitarianism. Liberty absent negative spillovers is inviolable for Mill, and utilitarian demonstrations that government could enhance welfare by violating individual liberty are not, regardless of extent, sufficient to justify government intervention. For Mill, there is a universal rule for *noninterference*, but not for *interference*: utilitarianism comes in, and only comes in, in the presence of harmful spillover effects.

35. It also seems at odds with Sidgwick's stated empirical approach to these issues.

It may surprise the reader to hear that one finds a similar optimism about the prospects for governmental reform evidenced in Smith's discussion in *The Wealth of Nations*. This was later to bring a harsh rebuke from George Stigler ([1971] 1982). Backhouse and Medema (2006) examine the visions of the state within the Cambridge tradition.

36. In this sense, Mill's perspective was more of a piece with the nonutilitarian branch of classicism than with that of his father and Bentham.

37. Note that I qualify this with "in some sense" to emphasize that the transition was not nearly so great as to be labeled "socialist." However, we had moved back to a preclassical view in the sense that the state was seen as a more overtly necessary player in the process of reining in the base effects of self-interest.

Mill's ([1859] 1992, 24) belief that utility is "the ultimate appeal on all ethical questions" tells us that he places individual liberty on a plane above ethical debates and beyond subjection to the utilitarian calculus. Such is not the case for economic activity, however. Trade fits into the utilitarian category because it is "a social act": "Whoever undertakes to sell any description of goods to the public, does what affects the interest of other persons, and of society in general; and thus his conduct, in principle, comes within the jurisdiction of society" (170). As Mill points out, the social nature of economic activity had long been recognized, and had functioned as the rationale for the extensive regulation of economic activity throughout the ages (see, e.g., Gordon 1975 and Medema 2003). Only "after a long struggle" did the benefits of free trade become more clear and cause a fairly dramatic change in thinking on this matter—as worked out in classical free-trade doctrine.[38]

What we have in Sidgwick is a well-developed view—one that he considered empirically based (but see O'Brien 1998)—both of the limitations of self-interested action operating through the market and of governmental attempts to improve on these outcomes. Here, simplistic and a priori approaches to questions of the role of the state give way to a thoroughgoing utilitarianism—one in which "the ultimate criterion of the goodness of law, and of the action of government generally, is their tendency to increase the general happiness" (Sidgwick [1891] 1897, 39). In terms of figure 1, above, there is no region in which government intervention is inappropriate or off limits in an a priori sense. In Mill's system, for government to intervene for a person's own good, "either physical or moral," is completely out of bounds. Sidgwick, in contrast, argues that while individualism is often consistent with utilitarianism, it is utilitarian concerns that are paramount. And, he says, from a utilitarian perspective, larger societal interests sometimes trump the dictates of individualism ([1874] 1981, 444–45). The fact that people are at times unable to see their own best interests or to take adequate care of themselves justifies, in his view, certain paternalistic actions on the part of government—hence the need for health regulations on foodstuffs, the licensing of physicians and other occupations, workplace safety regulations, and so on ([1883] 1901, 425). As such, Sidgwick evidences a much greater consistency in his utilitarian-

38. Mill's characterization of trade as a social act means that the justification for the doctrine of free trade derives from its social utility, rather than from individual liberty. As Mill ([1859] 1992, 170–71) notes, though, the social utility and individual liberty arguments are often compatible with one another.

ism than does Mill.[39] In part because of this, but also because of his less negative view of government agents, Sidgwick is also willing to allow for a much more expansive role for the state than is Mill.

The source of Sidgwick's critical attitude toward the a priori and abstract deductive approaches to examining the working of the system of natural liberty and the potential for improvements via the policy process lies in his utilitarianism,[40] and it is thus not surprising that Sidgwick would see things beginning to move in a better direction with the development of a more empirically grounded approach to these policy issues. The empirical turn is best exemplified, he maintains, in the work of Mill, who made things "more balanced, qualified, and empirical," and more in tune with modern science ([1885] 1904, 174). Sidgwick also finds empirical support for his position in the general mood of the day, where, he says, the "drift of opinion and practice is in the direction of increasing the range and volume of the interference of government in the affairs of individuals" ([1891] 1897, 143).[41]

In spite of his negative assessment of Ricardo's abstraction and his own belief that he could not himself be charged with "overrating the value of abstract reasoning on economic subjects, or regarding it as a substitute for an accurate investigation of facts" ([1885] 1904, 171), Sidgwick does not deny that there *is* a role for abstract theory in policy analysis. While the appropriateness of government interference in any particular case requires an examination of the various facets of the actual problem as it arises and cannot be resolved by appeals to abstract theory, abstraction can provide a framework for thought and analysis. It may, he says, "supply a systematic view of the general occasions for Governmental interference, the different possible modes of such interference, and the general reasons for and against each of them, which may aid practical men both in finding and in estimating the decisive considerations in particular cases" ([1885] 1904, 176). It can show when the "drawbacks" referred to above are likely to be least, and how they might be minimized, as well as when returns to private provision are not sufficiently large or where private and public interests are likely to collide.

39. John Rawls speaks to the greater consistency in the utilitarianism of Sidgwick as against Mill in the foreword to the 1981 reprinting of Sidgwick's *Methods of Ethics*.

40. At one point, he describes himself as a "mere empirical utilitarian" (Sidgwick [1886] 1904, 211).

41. He does note, however, that much of this expansion has to do with the protection of individuals from the effects of the actions of others, and to that extent can be seen as consistent with individualism (143).

In fact, Sidgwick ([1883] 1901, 417) suggests that abstract reasoning, far from supporting the laissez-faire orthodoxy, points in the same direction as his own approach: "The general presumption derived from abstract economic reasoning," he says, "is not in favour of leaving industry altogether to private enterprise . . . but is on the contrary in favour of supplementing and controlling such enterprise in various ways by the collective action of the community." This analysis shows that the flaws in the system of natural liberty mean that "various kinds of interference with industry . . . may be necessary or expedient" for dealing with industry issues such as cartels and monopolies, as well as "for the due protection of life, health, physical comfort, freedom, and reputation of individuals from harm inflicted, intentionally or otherwise, by private persons" (423).

Conclusion

Mill and Sidgwick both came at the question of the economic role of government from a utilitarian perspective and, in doing so, took the pragmatic view well (and increasingly) beyond that of the classical economists of the first half of the nineteenth century. Mill set himself apart from his classical forebears in attributing a much more expansive set of limitations to the system of natural liberty, but he shared with them a dim view of government agents and a resulting pessimistic view of the ability of government to improve on market performance—to the extent that the case for the "expediency" of intervention had to be "strong." Sidgwick ascribed an even greater set of failings to the system of natural liberty than did Mill. And, while Mill refused to subject individual liberty absent negative spillovers to the same utilitarian analysis as when spillovers were present, Sidgwick, in marked contrast, went all the way with utilitarianism and evidenced a great deal more optimism about the efficacy of government intervention.

The import of this transition for subsequent economic thinking flows from the significant influence that Sidgwick had on A. C. Pigou (1912, 1928, 1932), who, not long thereafter, took all of this a step further, grafting the analysis of the potential for market failure found in Sidgwick onto the emerging technical toolkit of marginal analysis (see, e.g., O'Donnell 1979, Backhouse 2006, and Medema 2007). The middle third of the twentieth century saw the fleshing out of Pigou's analysis as economists demonstrated, with steadily increasing analytical rigor, the conditions necessary for market optimum, the factors and forces that would cause market outcomes to diverge from the optimum, and the means by which governmental action could correct these market failures. The qualms regarding the ability of government to actually accomplish the correction of market failures, so much in evidence in classical economics, had all but disappeared. The role of government vis-à-vis the market was no longer an a priori set of assertions, nor an opinion based upon casual empiricism; instead, it was considered to be demonstrable in a "scientific" sense.

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