
A MISESIAN READING OF THE COASE THEOREM
A CALCULATION AND EQUILIBRIUM PROBLEM

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Abstract

This article puts forward a Misesian reading of the Coase Theorem with the conclusion that besides the concerns rose by Walter Block and Mario Rizzo calculation and equilibrium problems are present in the application of the theorem. A Misesian reading of the Coase Theorem shows two important problems. First, that for the judge is impossible to properly calculate in efficient terms due to the absence of specific prices in the problem he needs to solve. Second, the judge decisions has no neutral effects in the general equilibrium even if his decision is neutral in the partial equilibrium he is analyzing; this results in two different states of rest that cannot be compared. A Misesian reading shows that there are important practical challenges that the judge is unable to solve following an efficiency criteria.

Introduction

Ronald Coase's *The Problem of Social Cost* (1960) changed the way the problem of externalities is seen in economics. The idea that externalities are not a market failure, but rather an absence of market, shed new light on the problem. It is not a Pigouvian intervention that is needed to solve the problem, but property rights to bargain and correct the alleged market failure. That is, there is no failure of the market because there is no market.

It would be an endless task to review all of the places and articles where Coase and the theorem are discussed; interesting research on the different emphases and points of view employed when presenting the theorem has already been done.¹ Coase's reputation is certainly very well deserved. Nevertheless, it is interesting that Mises' treatment of external economies passes almost silent in the literature on the problem despite having some similar aspects to Coase's argument.² In Mises' most relevant work, *Human Action* (1949), a specific chapter is dedicated to the issue of "The Limits of Property Rights and the Problems of External Economies" (Chapter XXIII. 6). A Misesian reading of the Coase Theorem it is not only of interest to the history of economic thought as it can also bring new light to the problems surrounding the problem of externalities.

¹ Butler, M. R., & Garnett, R. F. (2003). Teaching the Coase Theorem: Are We Getting it Right? *Atlantic Economic Journal*, 31 (2), 133-146.

² Exceptions could be Stordeur (h), E., & Ramos Mejía, J. F. (2005). Una Lectura Hayekiana de Coase. *Libertas* (42) and Krause, M. E., Zanotti, G. J., & Ravier, A. O. (2007). *Elementos de Economía Política*. Chapter 4. Buenos Aires: La Ley.

While it is inevitable to briefly touch upon a few of the arguments already raised, for example, by Walter Block in his debate with Harold Demsetz or in Mario Rizzo's *Law amid Flux: The Economics of Negligence and Strict Liability Tort* (1980) and Edward Stringham's *Kalrdor-Hicks Efficiency Analysis and the Problem of Central Planning*, the aim of this article is to fill this gap by focusing on a Misesian reading of the Coase Theorem. This approach not only points out the different conclusions of the two authors from a history of economic thought perspective, but also raises economic calculation and equilibrium problems that are present in any judicial decision.

Before discussing the differences, it is necessary to briefly comment on the similarities between Coase and Mises in order to provide an adequate picture of the problem. The two authors start from a similar point before starting to differ as they move ahead. These similarities will be briefly discussed in the first section of the article. The second section will discuss the differences in more depth. It will first focus on some aspects on the conception of property rights that will be related to the limits in the application of the Coase Theorem. It will then show why, for Mises, the theorem will work differently as usually acknowledged. Finally, the third section will put forward the conclusions. It is important to note that because Mises' text is prior to that of Coase, he refers to the topic in a pre-Coasian way.

A Misesian reading of the Coase Theorem can help Austrian economists to argue that not only are there philosophical differences between the two approaches, but that even when working inside the framework of the Coase Theorem, Misesian objections can be put forward regarding the theorem's conclusions.

The Similarities

The main similarity between Mises and Coase is that both see that the problem is due to a defective pattern of property rights; they both contend that there is a private property rights issue. In addition, both understand that if property rights are properly defined, then externalities are internalized, avoiding problems of social cost and arranging resources. In the second paragraph of his chapter, Mises relates the issue of external economies and agents' conduct to property rights:

Carried through consistently, the right of property would entitle the proprietor to claim all the advantages which the good's employment may generate on the one hand and would burden him with all the disadvantages resulting from its employment on the other hand. Then the proprietor alone would be fully responsible for the outcome. In dealing with his property he would take into account all the expected results of his action, those considered favorable as well as those considered unfavorable. But if some of the consequences of his action are outside of the sphere of the benefits he is entitled to reap and of the drawbacks that are put to his debit, he will not bother in his planning about all the effects of his action.³

Thus, for Mises, there are certain problems in the arrangement or pattern of property rights affecting agents' decisions. This is caused by the presence of what he referred to as loopholes (*italics added*):

The laws concerning liability and indemnification for damages caused were and still are in some respects deficient. *By and large the principle is accepted that everybody is liable to damages which his actions have inflicted upon other people. But there were loopholes left which the legislators were slow to fill.* In

³ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 655.

some cases this tardiness was intentional because the imperfections agreed with the plans of the authorities.⁴

In this paragraph, Mises uses the traditional examples to point out that the problem in property rights originated because there were “loopholes left which the legislators were slow to fill.” Thus, for Mises, the political interference in liabilities and property rights leaves loopholes where externalities fall in. It should be mentioned that, despite Mises' remarks that this problem was due to government interference in the evolution of law, he acknowledges that a relief of responsibility may be also part of the spontaneous process of the common law.⁵

Mises then mentions that given that the loopholes are not a problem inherent to the market process, but were “left behind,” they need to be corrected; that is, the structure of property rights and liability assignments requires amendment (*italics added*):

It is true that where a considerable part of the costs incurred are external costs from the point of view of the acting individuals or firms, the economic calculation established by them is manifestly defective and their results deceptive. But this is not the outcome of alleged deficiencies inherent in the system of private ownership of the means of production. It is on the contrary a consequence of loopholes left in this system. *It could be removed by a reform of the laws concerning liability for damages inflicted and by rescinding the institutional barriers preventing the full operation of private ownership.*⁶

⁴ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. pp. 655-656.

⁵ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 656.

⁶ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. pp. 657-658.

Coase's treatment of the problem is well known. We can, however, cite a short paragraph where this problem of rights assignment can also be seen (italics added):

It is necessary to know whether the damaging business is liable or not for damage caused since *without the establishment of this initial delimitation of rights there can be no market transactions to transfer and recombine them*. However, the ultimate result (which maximises the value of production) is independent of the legal position if the pricing system is assumed to work without cost.⁷

Coase and Mises share common ground in seeing a problem with the structure of private property. However, they seem to differ in what they consider the problem to be. Mises seems to be clearer than Coase in distinguishing between a property right ambiguity and existing property rights not being respected, according to his example because of political reasons. Both, nevertheless, see the solution to this problem in the correction of the structure of property rights. How to do this and its consequences are where the main differences rest. Even if they differ somewhat in their understanding of the specific nature of the problem, namely the absence of property rights versus ignoring existing property rights, they both see a problem in the same place.

A Misesian Reading of the Coase Theorem

The differences between Mises and Coase fall into two categories: 1) property rights and externalities and 2) differences in the theorem.

⁷ Coase, R. H. (1960). The Problem of Social Cost. *Journal of Law and Economics*, 3, 1-44. p. 8.

Property Rights and Externalities

The above citations from Mises show that he is concerned with the liabilities of damages. In Coase, however, this seems to be a secondary aspect; at the beginning of his article, he expresses the reciprocal aspect of the problem in a well-known passage where he contends that to restrict the harm A causes on B implies a harm on A and that the lesser harm structure should be selected; as Coase puts it, the problem is to avoid the more serious harm.⁸

This general statement, where the harm problem is reciprocal, is applied to many cases, like the example of the man harboring rabbits that eat his neighbors' crops (*italics are original*):

The reason is not that the man who harbours rabbits is solely responsible for the damage; the man whose crops are eaten is equally responsible. And given that the costs of market transactions make a rearrangement of rights impossible, unless we know the particular circumstances, we cannot say whether it is desirable or not to make the man who harbours rabbits responsible for the damage committed by the rabbits on neighbouring properties. The objection to the rule in *Boulston's* case is that, under it, the harbourer of rabbits can *never* be liable. It fixes the rule of liability at one pole: and this is *as* undesirable, from an economic point of view, as fixing the rule at the other pole and making the harbourer of rabbits always liable.⁹

Thus, while there is a reciprocal relationship in case of damages for Coase, this is not the case for Mises. Mises would find it inconceivable to think of the crop owner as being responsible for the damages suffered just because the crops are there when the

⁸ Coase, R. H. (1960). The Problem of Social Cost. *Journal of Law and Economics*, 3, 1-44. p. 2.

⁹ Coase, R. H. (1960). The Problem of Social Cost. *Journal of Law and Economics*, 3, 1-44. pp. 37-38.

rabbits are the ones trespassing and destroying the crops. In the Misesian conception, one must consider whether the externality is damaging a private property before concluding reciprocity. This would draw a distinction between cases like an industry polluting a river and affecting the fishing industry on one side and a train burning crops or a rabbit eating crops on the other.

In the first case, the industry does not affect the private property of the fishing industry. The latter owns neither the river nor the fish that have not yet been caught. No party can claim that its property has been damaged, and as Coase points out, the permission to pollute or not imposes costs on the other party.

In the second case, there is actual damage to predefined property rights. This is an externality in the sense that something external has damaged a property, but it is not in the sense that the external cost happens through something that no one owns, revealing a loophole in the system. There is no discussion about to whom the crops belong. In a Misesian reading of the problem, the train owner's right to offer his services does not include the right to burn others' private property, and the rabbit owner's rights do not include the right to damage others' crops (even if Kaldor-Hicks applies); this was, for Mises, a loophole left in the system for political reasons.¹⁰

While Mises would suggest correcting the loophole by making the train and rabbit owners liable for the damages they caused to already-established property rights, Coase would suggest the use of the efficiency criteria as a guide; if transaction costs are high, then the judge should rule according to these criteria; if transaction costs are

¹⁰ See Rizzo, M. J. (1980). Law amid Flux: The Economics of Negligence and Strict Liability in Tort. *The Journal of Legal Studies*, 9 (2), 291-318. p. 312.

low, then it is unnecessary.¹¹ For Mises, this would not be an externality as an economic phenomenon in the absence of property rights; on the contrary, it would be an external cost caused by property rights violation. If the damage was inevitable, but there is no doubt about to whom the crops belong, then the proper compensation should be enforced rather than asking the judge to rearrange liability following efficiency criteria. This problem would not be solved by a rearrangement of property rights, but by judicial intervention to stop and compensate the damages caused, independent of who is the 'least cost avoider.'

Thus, we can divide negative externalities into types I and II. The first one does not involve private property damage (the case of the polluted river). The second one does involve damage of property rights (the case of the train or the rabbits).

This is not a superficial difference of opinion; it is founded on different conceptions of property rights. For Mises, property rights should not be modified to maximize efficiency, but this becomes a possibility for Coase as he considers both parties equally responsible. While, for Mises, property rights are exogenous, they may become endogenous for Coase. The shift in the conception of property rights was expressed by Walter Block in his debate with Harold Demsetz as follows:

But all this changed with Coase and his adherents. In this new view, property rights became the handmaiden of so called economic efficiency. The very determination of private property became dependent on cost considerations. Another way to put this is that in the pre-Coasian days, property rights were

¹¹ Note that in the case of low transaction costs, efficiency does not cease to be important. It is just unnecessary to refer to it as the market solves the problem by itself. Efficiency is, then, always in the background, even if it is not explicitly being addressed.

exogenous to economics. Thanks to Coase and his followers (Demsetz 1966, 1967; Posner 1989; Landes 1971, 1973, 1979), it is no longer true. Now, if anything, economics is the independent variable; property rights have become endogenous on it.

Further, reciprocity was nominated to take the place of previously sacrosanct causal relationships. It was no longer true that the factory that emitted sparks which set ablaze the farmer's crops was at fault. The latter became equally blameworthy, or rather, since it became no longer appropriate to relegate blame to anyone, responsible. Had the farmer not planted in that spot, no harm would have befallen him."¹²

Mises, in contrast, sees property rights as an exogenous phenomenon of the market process. It is not because a market exists that property rights arise; it is because there are property rights that there can be prices and a market. This follows his line of argument in the economic calculation debate.¹³ For Mises, property rights cannot be the result of transaction costs or any market process because they are the prerequisite of cooperation through the market; it is once there are property rights that prices and transactions can happen. This structure of property rights, however, is not perfect. There is a constant need for changes and adjustments in property rights and norms; this is Mises' argument that the spontaneous process of the market may leave loopholes to correct. Both similarities and differences between the two authors can be found in this area. Both would find ambiguity in the property rights structure, but their advice would differ. Mises would suggest a common law approach through the

¹² Block, W. (1995). Ethics, Efficiency, Coasian Property Rights, and Psychic Income: A Reply to Demsetz. *The Review of Austrian Economics*, 8 (2), 61-125. p. 62.

¹³ von Mises, L. (1935). Economic Calculation in the Socialist Commonwealth. In F. A. Hayek, *Collectivist Economic* (S. Alder, Trans., pp. 87-130). London: George Routledge & Sons.

study of the age-long evolution of the norms, but Coase puts more weight on an efficiency analysis on the part of the judge.

This distinction between the two types of externalities is the first difference between Mises and Coase. The second difference is how to solve the problem.

The Coasian reading suggests assigning rights in order to maximize efficiency. This is Block's contention that private property rights become dependent on economic efficiency, rather than economic efficiency being a problem to solve with the structure of property rights as given. If, by definition, there are no property rights, how does the Coasian judge calculate efficiency to assign liability? Mises follows a more evolutionary approach; in the first paragraph of his chapter, he mentions that "[p]roperty rights as they are circumscribed by laws and protected by courts and the police, are the outgrowth of an age-long evolution."¹⁴ In Mises' analysis, property rights evolve spontaneously; following a common law tradition, the role of the judges is to discover the law rather than to create it following efficiency criteria. A few pages later, Mises uses the tragedy of the commons example that would later be popularized by Garret Harding's article¹⁵ to illustrate how property rights appear spontaneously. When people begin to consider the predatory method wasteful, the institution of property rights starts to become consolidated.¹⁶

¹⁴ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 654.

¹⁵ Harding, G. (1968). The Tragedy of the Commons. *Science*, 162, 1243-1248.

¹⁶ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 656.

As we can see, in Mises, the norm arises when the benefits of internalizing the externalities cover the transaction cost of respecting property rights; a similar analysis to Demsetz's *Toward a Theory on the Origin of Property Rights* (1967). For Mises, there are economic reasons that may help to explain the evolution of property rights as well. If there is an externality that does not damage others' property, defining property rights for any of the sides involved may be inefficient, as the norm may result in more costs than benefits. If the economic value of the externality is so important, why is there not a property right already? In addition, how is it that the judge can know better than the market when and whom to benefit with the property rights? The visible hand of the judge may not be as efficient as the invisible hand of the market, as slow and imperfect as the latter could be. The problem is that the judge cannot base his decision on the science of human action simply because he lacks the required market information. He may employ a subjective hunch or intuition, but his decision is simply beyond the scope of the science of human action.

The application of the efficiency criteria to judges' decisions seems to suggest that there has been a shift in the problem of economic calculation from the sphere of the state to the sphere of the judge; the latter, however, is not in a better position to solve this problem than the state. The judge cannot solve his efficiency problem anymore than the socialist ruler can solve his. The judge may use as reference prices of "similar" goods in "similar situations" in other places or times. However, this is no different than the socialist government referring to the market prices of other non-socialist countries to solve his efficiency problem. Just as the socialist ruler cheats the socialist system when using outside prices as references, the judge cheats the efficiency criteria when he uses prices from outside the scope of the problem he must solve. As, by the

definition of externality, there are no property rights, the efficiency calculation cannot be performed on its proper grounds. If we want to be strict, as Stringham argued, the judge can only use prices from outside the scope of his problem, which also are past prices, and we cannot solve the efficiency problem without the assumption that those prices are valid as a reference.¹⁷ It has to be considered that prices are historical exchanged rations of particular goods between particular parties in a particular place and time. There is no such thing as the price of good x , but only the ratio of exchange a particular good x had at a particular time and place between two particular parties. To assume that such a price is valid as a reference, as the judge needs to do, require working outside the framework of praxeology or human action sciences. However, if this is so, then the efficiency rule of thumb suggestions rest on the strength of this assumption. Regardless of how similar these goods might be and how recent their past prices are, the judge cannot avoid the fact that he will need to refer to his subjective understanding of the situation. This fact alone demonstrates that the judge cannot solve the problem based on the rules of the science of human action, just as the socialist ruler is not being purely socialist when using free market prices to solve his socialist problem.

Furthermore, even if the judge decides to ignore this problem and recur to market prices to solve the problem, these prices are prices in disequilibrium, not in equilibrium, and the specific conditions of the equilibrium are unknown. It can happen, then, that the party determined to be the least cost avoider with prices in

¹⁷ Stringham, E. (2001). Kaldor-Hicks Efficiency Analysis and the Problem of Central Planning. *The Quarterly Journal of Austrian Economics*, 4 (2), 41-50.

disequilibrium would be in a different situation with prices in equilibrium. Thus, as Rizzo pointed out, it may happen that the judge may put forward an inefficient rule precisely because he was following the efficiency criteria.¹⁸ It is not only that the judge cannot avoid the need of recurring to external prices to solve an internal problem, but that market prices are a reflection of disequilibrium more than of equilibrium.

A Misesian reading of the problem of externalities is not only more consistent with the conception of property rights, but also more concise in its praxeological construction. Mises is not suggesting any economic calculation of any sort, but study of the age-long evolution of the norms. Because the judge cannot objectively solve the problem, he should recur to the evolution of the structure of norms present in his society. It is true, as Coase's analysis suggests, that we can imagine a different arrangement of norms for a given society, and regardless of whether the structure of property rights in the initial period always reaches the same final assignment of resources, the problem any judge faces is different from that of assigning property rights in any initial period because he is already immersed in a specific evolved set of norms. He needs, as Mises suggests, to study this specific set of norms that has been evolving for a long time. Some normative arrangement may be incompatible with the actual evolved set of norms, even if it happens to be more efficient.

The conceptual difference in property rights also appears at the moment when the judge makes his decision. In Mises' chapter on property rights (Chapter XXIV. 4), he distinguishes between the economic (catallactic in his terminology) and legal

¹⁸ Rizzo, M. J. (1980). Law amid Flux: The Economics of Negligence and Strict Liability in Tort. *The Journal of Legal Studies*, 9 (2), 291-318. p. 309.

meanings of private property. In economic terms, private property means that the proprietors have the freedom to determine the employment of the factors of production.¹⁹ That is, it does not matter if any given individual is said to be the owner of any given resource if another one, i.e., the government, dictates what to do with it. If the judge can make liable the crop owner because he is the least cost avoider, in what sense is the farmer the “owner” of “his” crops? Who is the real owner of the crops, the farmer or the judge?

For this reason, for Mises, liability assignment cannot be defined as a byproduct of efficiency. If Coase and Mises were neighbors and Coase’s dog accidentally escaped, got into Mises’ house through an open window and damaged his furniture, should Mises be responsible because he would be the cheapest cost avoider by closing his window than Coase, who would have had to chase his dog? While it seems that this line of argument could work for Coase, it would be unacceptable for Mises. This norm would be incompatible with the actual evolved set of norms.

In sum, while a Coasian approach would accept imposing liability on the owner of the damaged property if he is the least cost avoider (as in the train and rabbits examples), the traditional approach Mises follows would find that unacceptable as there are already property rights assigned: the problem is not the absence of property rights, but the fact that they are being ignored.

In the case of an external cost caused through something without an owner (as in the example of the river), where there is no property damage, Mises finds an economic

¹⁹ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 683.

drive for new property rights to emerge and internalize externalities, but it seems odd to assume that he would suggest that the judge should follow a least cost avoider rule of thumb to assign property, but follow the tradition and ethical rules of the community as in a common law practice. For Mises, economic calculation, which is needed to perform the efficiency analysis, requires the previous existence of property rights because without them there cannot be prices. Thus, as Rizzo points out, the problem of how to assign property rights cannot be answered following an efficiency economic calculation because such suggestions presuppose the existence of the same thing that is needed.²⁰

As Block suggested, Mises, as a pre-Coasian and classical liberal, does not understand property rights as variable to maximize efficiency, but as an institutionally given tool from which efficiency should be obtained.

Differences in the Working of the Theorem

The previously discussed differences in externalities and the conception of property rights are the fundamental divergences between Coase and Mises. These, along with other aspects, are helpful to spot the differences between a Coasian Coase Theorem and what would be a Misesian Coase Theorem.

Mises' line of thought suggests two differences from the conclusion of the Coase Theorem without transaction costs. The first one has to do with the conclusion that in

²⁰ Rizzo, M. J. (1980). Law amid Flux: The Economics of Negligence and Strict Liability in Tort. *The Journal of Legal Studies*, 9 (2), 291-318. p. 299.

such a scenario, resources would be efficiently applied independently of which side is assigned. The second difference has to do with the neutral aspect of property rights.

The first point was raised by Block in his debate with Demsetz.²¹ Block proposed a scenario in which a train, instead of burning crops, burns a flowerbed with an important emotional value for the owner but no market value. In this scenario, Block argues, if the right to burn is assigned to the train owner, the gardener may not be able to pay the train to not burn his flowerbed if there are wealth constraints; the conclusion that to whom the right is assigned is indistinct is not necessarily true, even with zero transaction costs. It is not necessary to revisit all aspects of the debate between Block and Demsetz; it is sufficient to point out that, for Mises, income and costs are ultimately subjective (psychic in Block's article) and are always present. Thus, the conclusion that in a zero transaction costs is irrelevant to whom rights is assigned is not necessarily true.

It needs to be pointed out, however, that this does not necessarily indicate a problem in the logical construction of the Coase Theorem, but it requires the implicit assumption of no psychic benefit or cost with and no wealth constraints. The absence of psychic income is, however, alien to Mises' conception of the market process as for

²¹ Block, W. (1977). Coase and Demsetz on Private Property Rights. *The Journal of Libertarian Studies*, 1 (2), 111-115; Demsetz, H. (1979). Ethics and Efficiency in Property Rights. In M. Rizzo, *Time, Uncertainty, and Disequilibrium. Exploration of Austrian Themes* (pp. 97-116). Lexington, Toronto: LexingtonBooks; Block, W. (1995). Ethics, Efficiency, Coasian Property Rights, and Psychic Income: A Reply to Demsetz. *The Review of Austrian Economics*, 8 (2), 61-125; Demsetz, H. (1997). Block's Erroneous Interpretations. *Review of Austrian Economics*, 10 (2), 101-109; Block, W. (2000). Private-property Rights, Erroneous Interpretations, Morality, and Economics: Reply to Demsetz. *The Quarterly Journal of Austrian Economics*, 3 (1), 63-78.

him every individual decision is driven by weighing subjective preferences against expected income and costs. By assuming away psychic income and costs, the model would deal only with a very particular subset of all cases where external costs are present. Such cases may be too specific and rare to draw general conclusions. It is not the presence of psychic income and the absence of wealth constraints that should be considered as an exception, but its absence.

The second difference comes from Mises' well known rejection of the concept of neutrality in asset changes, among them money.²² Mises, following Menger's theory on the origin of money, defines money as the most marketable commodity.²³ For Mises, any asset can play the role of money in an economic sense in any given exchange, independent of whether or not it has that legal definition. Mises' opposition to the idea of neutrality in money changes is a particular case of changes in assets in general. As long as the externality has economic value, when assigning property rights to any given agent, the agent's asset structure changes, with non-neutral effects on the market as a whole, just as happens with money. Expressed in neoclassical terms, the Coase Theorem is focused on the partial equilibrium of the particular conflict but is silent with respect to what happens to the general equilibrium when assigning property rights. The neutrality of the partial equilibrium cannot be extrapolated to the general equilibrium. That is, even if transaction costs are equal to zero and the parties involved in the conflict always assign the resources in the same way, the final state of

²² von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). New York: The Foundation for Economic Education. p. 413.

²³ von Mises, L. (1949). *Human Action. A Treatise on Economics* (1996 ed.). Chapter XVII. New York: The Foundation for Economic Education.

the rest of the economy would differ according to the party to whom private property rights are assigned. Thus, although the partial equilibrium may remain unchanged, the general equilibrium is dependent on the judge's decision. In what sense, then, can we say that if there are low transaction costs, the judge's decision to assign property rights is irrelevant or neutral?

For the judge's decision to be neutral, it is required that there are no wealth changes when assigning liability. This can only happen if the market value of the externality is zero, which would cause the problem to dissolve itself in the first place. As long as the externality has any market value, the judge cannot make any ruling without affecting the final state of rest. This situation raises two problems. First, if the final state of rest is different, how does the judge compare and choose between them?²⁴ Second, even if we grant the rare possibility that the state of rest could be the same (as small as this probability could be), how do we know that the specific path to such a state of rest has not been modified (in structure and length)? And if it has been modified, how, again, does the judge compare them? The judge, who is not an ideal eyewitness of the market but is in the same condition as any other individual in the market, does not possess the required information to solve this problem, and if he cannot solve this problem it is beyond him to efficiently use the efficiency criteria. As Rizzo (1980) concludes, the efficient criterion is not only a doubtful principle by which to guide judges' decisions, but is impossible to follow properly.

²⁴ Note that this requires the further assumption of perfect knowledge to know how each final state of rest will be.

Mises would be contradicting himself if he did not reach the same non-neutrality conclusion with changes in assets just because they are less marketable than money and define money as a marketable good at the same time. For Mises, asset changes are neutral neither in the short nor the long term. In the long run, the final state of rest is different, or more precisely, cannot be affirmed to be the same, and so property rights assignments cannot be considered neutral in the economy as a whole, even if they are neutral for the particular resources involved in the externality phenomenon.

Note that this non-neutrality conclusion is focused on the general equilibrium, regardless of what happens in the partial equilibrium. While Block's argument lies inside this partial equilibrium, the non-neutrality principle can be applied to the general equilibrium, even if we are not in the presence of a case like Block's example.

Kirzner also suggested that assigning property rights is not sufficient to guarantee efficient bargaining as entrepreneurial alertness still requires discovering the opportunities. Having access to costless information does not imply knowing where the opportunities are; the information still needs to be interpreted subjectively.²⁵ The Hayekian analysis of information and knowledge applies as well. Even if the judge has all of the information available to perform the efficiency calculation, he still needs to interpret it correctly; the knowledge of different judges may vary even if they are evaluating the same body of information. Because the same information can be subjectively interpreted differently, complete information does not necessarily guarantee equilibrium or efficiency, as the agents may be interpreting the available

²⁵ Cf. Kirzner, I. M. (1973). *Competition & Entrepreneurship*. Chicago: The University of Chicago Press. pp. 226-227.

information differently or wrongly. Successful coordination requires more than just information; it requires coordination of subjective expectations and knowledge as well.

Why did Mises not put forward these conclusions in this way in his section on external economies and property rights? There are at least two possible reasons. First, he wrote his chapter before Coase's *The Problem of Social Cost* was published, and this was not the standard exposition of the theme at the time. Second, for Mises, property rights cannot be defined, as he expressed in his section of property rights, following efficiency criteria. Assigning the property rights to one side assigns the costs to the other, even in cases where there is no damage to property rights (as in the example of the polluted river). This assignment of liability implies a decision regarding ethics and justice on the part of the judge; but this question of justice cannot be answered based on efficiency. Even if the judge wanted to follow an "efficiency ethics rule", he would not have the information he needs. He may put forward an opinion on an existing situation where property rights already exist and there are market prices, but if, in the case of externalities, there is an absence of property rights by definition, then he cannot apply the "efficiency ethics rule" to solve the problem, but only to analyze non-problematic situations.

This difference in the property rights conception also affects the case where there are transaction costs. This is the scenario that Coase suggested as the most interesting. As in the real world, there are transaction costs that may prevent resources from being optimally assigned, it is recommended to follow the efficiency rule when assigning property rights and to stay as close as possible to the ideal scenario of no transaction costs. In such cases, following Mises' citations, for him it would be advisable to first

see if the loopholes are not due to government interference; if there are clear economic incentives, the market would probably have corrected them already.

If this is not the case, then the judge needs to determine where the liability falls if there is no damage to property. While Coase's suggestion involves looking for the cheapest cost avoider, for Mises this is not to be answered through economic efficiency, but by the judge studying the “age long” evolution of the social norms in what could be described as a Hayekian position.

It is important to mention, however, that despite Coase's clear emphasis on the efficiency criteria, some of this evolution consideration seems to still be present in his conclusions:

But it is, of course, desirable that the choice between different social arrangements for the solution of economic problems should be carried out in broader terms than this and that the total effect of these arrangements in all spheres of life should be taken into account. As Frank H. Knight has so often emphasized, problems of welfare economics must ultimately dissolve into a study of aesthetics and morals.²⁶

Mises, however, seems to have been clearer in distinguishing between cases in which there are no property rights assigned and those where property rights do exist but are being ignored.

Conclusions

The differences between Mises and Coase on externalities and property rights can be divided into two levels. The first is the economic aspect of the functioning of the Coase Theorem. On this level, there are two differences. On one hand we have that

²⁶ Coase, R. H. (1960). The Problem of Social Cost. *Journal of Law and Economics*, 3, 1-44. p. 43.

the subjective aspect of income and costs in Mises would not allow him to conclude that the final allocation of resources is independent of property rights, even with low transaction costs, as Block's example shows. On the other hand, as property rights allocation implies a change in relative assets, this involves non-neutral changes in the economy as a whole, and the final states of rest would differ depending on the party to whom the property right is assigned. The judge simply cannot make a neutral decision in the economy as a whole; he is unable to perform only as an efficiency calculator. This second aspect presents new challenges to the Coase Theorem as it needs to argue a general, rather than only partial, neutrality; if not, it requires the judge to extent his efficiency calculation beyond the borders of the partial equilibrium to the market as a whole to reach a consistent solution. It is impossible that any judge could perform such an analysis free of reasonable doubt of his results, even before taking into consideration the subjective valuations of each individual.

The first difference mentioned has to do with the implications of the different conceptions of property rights. Coase Theorem is built on the idea that it should be followed when property rights are not clearly defined. Not all of his examples, however, seem to follow this situation. The owner of the crops does not lose ownership because his neighbor's cattle damage his crops "by accident" instead of on purpose. There is no doubt to whom the crops belong, just as there is no doubt in the example of the river that the river does not belong to anyone. These examples are not analogous; the first would not apply for the Coase Theorem because property rights are clearly established. The judge would need to decide on the amount of the compensation, but not on liability. The main difference in the second case is that Coase's Theorem suggests following efficiency criteria, while Mises suggests the study

of the age-long evolution. This difference rests in the fact that, for Mises, the judge does not create, but discovers, the rules; while the suggestion to follow an efficiency criterion to assign liability and property rights implies that the judge creates the rule rather than discovering it.

It is true that Mises did not present the problem as Coase did, mainly because of a different conception of property rights, but it does not seem too forced to suggest that Mises advanced some of the Coasian aspects of the problem, as with the Tragedy of the Commons, on more solid grounds. That he dealt with this issue in a specific chapter of his most important work, rather than in a hidden chapter of an obscure book, shows that he saw this problem as relevant as well. A Misesian version of Coase not only helps to spot the differences between the two authors from their different conceptions of property rights and market processes; it also shows that the judge faces an problem he cannot solve due to lack of information and that any decision he may take has no neutral effects that he cannot compare. The efficiency criterion is beyond the possibilities of the judge.

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