

Austrian

Economics Newsletter



Ronald Coase Awarded Nobel Prize

Ronald H. Coase was awarded the 1991 Nobel Prize in economics for his role as one of the principal founders of the modern study of law and economics. He is best known for the "Coase Theorem"—the proposition that resources will be efficiently allocated through voluntary agreement even in the presence of externalities such as pollution, if property rights are defined—and for pioneering the economic analysis of the internal working of the firm.

Coase has made pathbreaking contributions to the theory of organizations, the theory of cost, property rights, public goods, externalities, economic method, as well as important works on the origins of monopoly. His work promotes the expansion of our understanding of the market process while eschewing mathematical techniques. A proponent of the importance of ideas, Coase showed that personal freedoms (speech, religion, press) were parallel with economic freedoms.

The British-born economist was educated at the London School of Economics where he was heavily influenced by Arnold Plant and F.A. Hayek. The works of this fellow traveler of the Austrian school, while few,

have had a tremendous impact on mainstream economists, and in particular a beneficial impact on the Chicago school. As one observer noted: "It is one of the few times the Prize has been given to an economist for advancing economic theory!" ▲

Coase's Nobel Prize

by Roy E. Cordato

Should Austrian economists celebrate on the occasion of Ronald Coase's Nobel Prize? Yes we should, but cautiously. First some background.

In 1960 Ronald Coase published an article that revolutionized the way a large segment of the economics profession has come to think about externalities problems. In "The Problem of Social Cost," Coase argued that the Pigouvian approach to assessing such issues was wrong and that it implied policy prescriptions that could lead to less than optimal results. Coase took issue with Pigou's focus on the divergence between private and social costs that externalities generate. Ultimately, Coase argued, from the perspective

BULLETIN BOARD

An Austrian economics weekend, March 27–29 at the University of Nevada, Las Vegas.

A conference on the Federal Reserve at Jekyll Island, Georgia, May 8–10.

1992 Mises University, July 4–11, at Stanford University.

Mises Institute 10th anniversary celebration October 9–11 in New York City.

\$1,000 Ludwig von Mises Paper Awards (see back page).

For more information contact the Mises Institute, Auburn University, Auburn, Alabama 36849-5301; (205) 844-2500; fax (205) 844-2583.

of social welfare, private costs are unimportant and that the issue of externalities is entirely a *problem of social cost*.

This led Coase to ask different kinds of questions than had typically been asked when assessing problems associated with negative externalities. Pigouvians had focussed on trying to transform social costs into private costs. This led to the conclusion that the costs of externalities should be internalized by those who are generating them, specifically through excise taxes or, with respect to legal remedies, by holding the generator of the externality liable for all damages. Coase's strict emphasis on social cost led him to recast the nature of the problem. He argued that "what has

to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of the harm" (p. 27). The ultimate social welfare goal, in Coase's framework, is to maximize the social value of output (p. 16). From this perspective, then, it is clear that internalizing the harm may or may not result in optimality.

Coase's emphasis on minimizing social costs led him, and those who have adopted his method, to consider how alternative institutional arrangements, that is, property rights, affect the efficiency of market outcomes. Viewing negative externalities as primarily a problem of conflicting property rights, Coase argued that what must be determined is "the arrangement of right [that] may bring about a greater value of production than any other" (p. 16).

The first case considered resulted in what has come to be called the "Coase theorem." Here Coase assesses the property rights conflict in a world of zero transaction costs. In this case, the optimal arrangement of property rights comes about strictly as the result of a voluntary bargaining process. In the second case, high transaction costs block the efficient outcome and it is suggested that a third party, most likely a judge, should intercede to impose the optimal solution.

Certainly, from an Austrian perspective, there is much to criticize in Coase's analysis.¹ In both the zero and positive transaction costs cases, Coase assumes that all prices are general equilibrium prices (pp. 6, 32), which allows him to ignore the problems that are posed by subjective value theory. For Austrians, the entire concept of "social cost" is vacuous (see Littlechild 1978). Furthermore, while Coase essentially argues that property rights are the most important variable when it comes to assessing externality problems, Austrians have always argued that property rights must be taken as a given.

In spite of these differences and the sometimes bitter debates that have ensued as a result of them,² Austrian economists should be rejoicing over Coase's Nobel Prize. Coase's approach to externalities has opened the door for Austrian ideas on this issue. Beginning with Menger, Austrians have always seen externality problems in terms of conflicts in the use of property, (see Cordato 1992, chap. 1). But since Pigou, property rights have been ignored by mainstream economists. Coase, invoking the methods of neoclassical economics, successfully shifted the focus and was able to place the issue of property rights at the center of the debate. This has bridged an important gap for Austrian economists.



Austrian Economics Newsletter

Volume 13, Number 2

CONTRIBUTORS TO THIS ISSUE

Roy E. Cordato is an economist with the Institute for Research on the Economics of Taxation in Washington, D.C.

Roger W. Garrison is an associate professor of economics at Auburn University.

Hans-Hermann Hoppe is professor of economics at the University of Nevada, Las Vegas.

Peter G. Klein is a Mises fellow and graduate student in economics at the University of California, Berkeley.

Frank Mixon is a Ph.D. candidate in economics at Auburn University.

STAFF

Editor: Mark Thornton/Auburn University

Associate Editor: Jeffrey A. Tucker/George Mason University

Assistant Editor: Peter G. Klein/University of California, Berkeley

Managing Editor: Judith F. Thommesen

CORRESPONDENTS

Amy Marie Marshall/University of Notre Dame

Alexander Tabarrok/George Mason University

PERMISSIONS AND SUBMISSIONS

Change of address requests and subscription requests should be addressed to *Austrian Economics Newsletter*, Mises Institute, Auburn University, Auburn, AL 36849-5301.

Questions pertaining to submissions of articles and book reviews should be addressed to Mark Thornton, *Austrian Economics Newsletter*, Economics Department, Auburn University, Auburn, AL 36849-5242.

Articles that are submitted should be double-spaced and no more than 6 pages in length. Articles that are accepted will be requested on an IBM format diskette, when possible. There is no submission fee.

Permission to reprint articles is hereby granted provided full credit and address are given.

Copyright © 1992 The Ludwig von Mises Institute, Auburn University, Auburn, AL 36849-5301; (205) 844-2500; fax (205) 844-2583.

While the differences in method and approach to public policy that separate Coaseans and Austrians should not be ignored, neither should an important and basic similarity, namely that both see externalities in terms of conflicts over the use of property. By bringing this focus to mainstream debates about externality problems, particularly in the areas of environmental economics and law and economics, Coase has provided a significant positive externality for Austrian ideas on these issues. His Nobel Prize only enhances these benefits.

¹For an extensive discussion of Coasean analysis from an Austrian perspective see Cordato (1992), Chap. 5. See also Boettke (1989) and Cordato (1989).

²See the collection of papers by Rizzo, Rothbard, Egger, and Demsetz, in Rizzo (1979).

References

Boettke, Peter. 1989. "Comment on Joseph Farrell, 'Information and the Coase Theorem.'" *Journal of Economic Perspectives*. Vol. 3, No. 2.

Coase, Ronald. 1960. "The Problem of Social Cost." *The Journal of Law and Economics*. Vol. 3.

Cordato, Roy E. 1989. "Subjective Value, Time Passage, and the Economics of Harmful Effects." *The Hamline Law Review*. Vol. 12, No. 2.

—. 1992. *Efficiency and Externalities in an Open Ended Universe: A Modern Austrian Alternative*. London and Boston: Kluwer Academic Publishers.

Littlechild, Stephen C. 1978. "The Problem of Social Cost," in Spadaro, ed., *New Directions in Austrian Economics*. Kansas City: Sheed, Andrews, and McMeel.

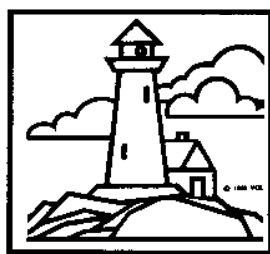
Rizzo, Mario, ed. 1980. *Time, Uncertainty, and Disequilibrium*. Lexington, Mass: Lexington Books. ▲

Ronald Coase and the Lighthouse

by Frank Mixon

The classical economists argued for government control of lighthouses for various reasons. Adam Smith advocated a toll for lighthouse users, but a toll collected by the public authorities, since private individuals would neglect the repair of the lighthouse. John Stuart Mill believed that government should build and maintain lighthouses because it would be impossible to secure a toll from the ships that benefit—the classic free-rider argument. For this reason he felt no private individual would construct a lighthouse.

Henry Sidgwick stated that the benefits of a well-placed lighthouse would be enjoyed largely by



ships on which no toll could be conveniently imposed. In cases where owners are able to collect tolls (e.g., roads and canals), Sidgwick argued that the tolls tend to be excessive, while conditions are often neglected. He fashioned a case for local taxation to provide for lighthouses since their beams offered local benefits. If the benefits of the lighthouse were dispersed nationally, then general taxation should be used to finance lighthouses.

A. C. Pigou pointed out that in the case of the lighthouse, the marginal private net product falls short of the marginal social net product, because the beam performs services to third parties (the dreaded free-riders), from whom it is technically difficult to exact payment. Since lighthouse tolls are impossible, then, private resources will fail to find their optimal uses. This classical view would ordain lighthouses as the "classic" example of a public good in textbooks of the future.

Then in 1974, Ronald Coase pointed out that the private production of lighthouses was not an impossibility it was an historical fact.¹ He presented evidence from England that lighthouses were constructed privately (and run profitably) beginning in 1614, when Trinity House, the governmental lighthouse agency, failed to answer a petition for a lighthouse along the rocks of Eddystone. The history of British lighthouses points out the merits of private production. In 1816, 34 of the 46 lights were under private ownership. Coase also showed that private producers typically maintained the quality of service, and offered generous pensions to lighthouse keepers and even educational assistance for their children. Coase's findings were not an isolated accident, as I will attempt to show by using facts from American history.

The history of lighthouses in the United States is much like that of England. In 1791, the U.S. government, with Alexander Hamilton as the Secretary of the Treasury, signed a bill that assumed control of all American lighthouses. This bill also ceded title of all private lighthouses to the government, with Hamilton appointing a superintendent of lighthouses to each state. But the facts show an inconsistency in the enforcement of this law, since some lighthouses after 1791 seem to have been maintained privately.

America's first lighthouse, Boston Light, was erected under the supervision of John George, a merchant, along with many of his associates in Boston. The lighthouse was built on Beacon Island, and any ship using the harbor was required to pay the receiver of impost a duty of one penny per ton going in or out of Boston Harbor. This was the first

light erected in the Western Hemisphere, and its construction and maintenance were entirely private.

New Hampshire's first light was Portsmouth Light, which was erected in 1771 on Newcastle Island. This beacon was not in fact a lighthouse, but a lantern that was hoisted to the top of a flagpole. The cost of raising and lowering the lantern was paid for by the ships that benefited from the "gleam of the lantern" in the harbor. The identity of the private individual who maintained the light and received the tolls remains a mystery today, but it is said that he directed an ox team that delivered gun powder to Americans at Bunker Hill.

The inhabitants of Nantucket received use of a lighthouse for their harbor in 1746. Several sea captains of the island came to the old New England town meeting on January 24, 1746, and pressed for construction of a lighthouse. Ebenezer Galet, Obed Hussey, and Jabez Bunker agreed to build a light and sell it to several citizens of Nantucket for £200. When the light was completed, another town meeting was held stating that "the owners" and "others concerned" would maintain the light. The lighthouse owners made it clear to ship owners that the lighthouse was their own maritime responsibility. The ship owners performed their tasks well, and the Brant Point Light gleamed every night. The work the ship owners shared in maintaining the light was their "toll" for its services.

To accommodate the complaints of some ship captains, the owners of the lighthouse set up a system of collecting dues from all ships using the harbor. The system required any vessel over 15 tons to pay a charge of six shillings the first time each year it entered or left Nantucket Harbor. An inspector collected the tolls for maintenance of Brant Point Light. This shows that shippers and ship owners were willing to pay a toll for lighthouse service, indeed; the system of monetary payment was preferred over the system of payment-in-kind.

For many years several residents of Martha's Vineyard maintained a private lighthouse at East Chop. The lighthouse was maintained by "subscriptions" from the owners of several steamers that sailed in the vicinity. The light was maintained until 1875, when the government purchased the sight and lighthouse for \$5,000.

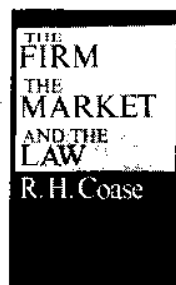
The lighthouse may be a "public good," but it need not be built, maintained by, or financed by the taxpayer. Evidence from U. S. history supports Coase's contention that the "public good characteristics" of the lighthouse need not make it a public enterprise. Indeed, the historical record implies that

private production may result in better lighthouse services. Private producers responded to "petitions" when the government failed to produce lighthouses and to the complaints of their customers. The evidence examined suggests that the private sector produced lighthouses in a cost-effective manner, and contrary to economists such as Henry Sidgwick, maintained the lighthouses efficiently.

The importance of Coase's classic article goes far beyond the gleam from the private lighthouse. Coase ruffled the heavy veil of ignorance facing mainstream economists regarding public goods theory. No longer is the public production of "public goods" left unchallenged. The long list of widely accepted public goods has shrunk, so that the public provision of public goods has come more to represent a last resort, and the privatization of public enterprises has become the wave of the future.

*Franklin G. Mixon, Jr., "Essays on the Economics of Property Rights: Lighthouses and Alligators," unpubl. Master's Thesis, Auburn University, 1990.

¹Ronald H. Coase, "The Lighthouse in Economics," *Journal of Law and Economics* 17, no. 2 (October 1974): 357-76. ▲



The Firm, the Market, and the Law

R. H. Coase
University of Chicago Press, 1988

Reviewed by Peter G. Klein

For an economist who wrote relatively little, Ronald Coase's influence has been enormous. Still, his receipt of the 1991 Nobel Prize in economics is a strange and wonderful thing, though Coase has been a favorite "dark horse" candidate for several years. What's remarkable is how far Coase is from the stereotype of the modern academic economist. His long-time appointment at the University of Chicago is with the school of law; he reasons like a lawyer, producing long essays of simple argument, careful documentation, and proof by example rather than tortured mathematics; and his reputation among economists is based almost entirely on two journal articles, one more than 50 years old and the other so long that few people have read it all the way through.

In 1988 the University of Chicago Press issued a collection of Coase's papers as "The Firm, the Market, and the Law." Included are the two famous ones—"The Nature of the Firm" (1937) and

"The Problem of Social Cost" (1960)—along with the well-known pieces on marginal cost and the lighthouse, a 1972 survey of the field of industrial organization, and two new essays, "Notes on the Problem of Social Cost" and a lengthy introduction. It is a good representation of Coase's style and thought, and a useful tool for understanding two major forces in contemporary economics: the law and economics movement, and what has come to be known as the "New Institutional Economics."

Coase did not originate the economic analysis of law, which developed into a systematic program under Aaron Director at Chicago in the 1940s and 1950s, but his paper on social cost that produced the "Coase theorem" is the best-known achievement of law and economics. Coase's main contention—that as long as property rights are well defined, external effects can under certain conditions be bargained away, no matter who holds the specific property titles—has met with varying degrees of enthusiasm. Nonetheless he did provide a new framework for thinking about property and externalities that has become widely influential. (It is mostly forgotten that the second half of Coase's paper provides a set of guidelines for judges to settle such disputes when barriers to efficient bargaining do exist; the charge that Coase ignores "transaction costs" is hence unfounded.) In the companion essay "Notes on the Problem of Social Cost," Coase demonstrates his uncommon conviction that economics ought to be useful as well as true. Responding to a critic who defends a classical Pigouvian tax plan as mathematically correct, though admittedly useless, Coase observes that "[i]n my youth it was said that what was too silly to be said may be sung. In modern economics it may be put into mathematics" (p. 185).

The other of Coase's legacies is the new theory of the firm or new institutional economics. It was Coase's "Nature of the Firm" that first urged economists to view the firm not as a set of demand and cost curves, but as an *organization*, with an internal structure guided by the same rules of human action that govern its external activities. This line of thought has finally developed into a systematic research program, with the growth of the highly technical literature on information and incentives of the last 20 years or so, and the work of writers like Oliver E. Williamson and Douglass North.

We are lucky that Coase's main works are few enough to be collected into one small book (Hayek's collected works, by contrast, are projected at around 20 volumes). The publishers could actually have included a few more selections, but we needn't quibble. *The Firm, the Market, and the Law* does contain the core of Coase's contribution to eco-

nomics, and he is without a doubt one of the most powerful and creative minds in the discipline. ▲

Values for a Value: Southern Schools Dominate

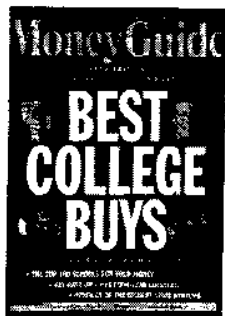
Choosing a college is perhaps one of the most difficult decisions, especially if you are looking for a school that promotes instruction in Austrian or free-market economics. With the state becoming increasingly involved in secondary education, quality is falling while the costs of a degree continue to escalate. The results of the John Templeton Foundation's Honor Roll of Free Enterprise Teaching and the *MoneyGuide* "value" survey of American universities and colleges are presented here to provide some information in making that choice.

Schools known for their emphasis on Austrian and free-market economics were highly ranked in both the Templeton and *MoneyGuide* Magazine surveys. Southern schools dominated both surveys. Institutions that were ranked in both surveys are listed in the table below.

The Templeton Foundation survey (conducted by the Foundation for Economic Education) asked the presidents of universities and colleges if they "(1) teach the principles and benefits of free-market economic systems, (2) encourage a high degree of personal initiative, responsibility, and accountability, (3) emphasize Constitutional concepts of limited government, (4) support the traditional work ethic and pride of productivity, [and] (5) foster an appreciation for private property rights."

Southern schools were selected as four of the top seven institutions and 46 out of a total of 87 selected. Seven schools were selected from the West and Northwest, 12 from the North, and 19 from the combined areas of the Midwest and Southwest.

MoneyGuide evaluated 1,011 institutions based on price and quality. Out-of-state tuition was used to determine the overall price of public institutions. To measure the quality of instruction the student/faculty ratio, the percentage of full-time instructors with Ph.D.s, library resources, and the percentage of resources devoted to instruction were examined. Entrance exam scores (SAT) and class rank of incoming freshmen, as well as the school's acceptance rate were used to measure the quality of the student body. Freshman retention rate and graduation rate were used to gauge overall student satisfaction. *MoneyGuide* used the percentage of graduates who go on to earn graduate,



professional, and doctoral degrees and the number of graduates listed in *Standard and Poor's Executive/College Survey* as a measure of the institution's output success.

The South dominated *MoneyGuide's* list of top 100 institutions

for price and quality with 5 out of the top 10, and 41 listed in the top 100, plus all ten of the top-ranked mid-sized schools. The often-touted quality of Northeastern schools is purchased at a very high price, with nine of the top ten highest priced schools located in the Northeast (averaging \$22,500 per year).

For those interested in a quality education at an institution known to have some interest in the free enterprise system these surveys provide some information. However, a few words of caution are in order. Surveys and statistical ranking models are merely formalized guesses based on specific criteria and limited information. The college decision can involve as much as \$150,000 in direct expenses. Evaluation of specific departments (i.e., economics), campus visits, family traditions, and financial aid packages can all play major rolls in your decision. ▲

Institution	Templeton Honor Roll	MoneyGuide Top 100
Hillsdale College	1	96
University of Chicago	2	69
George Mason University	3	—
Grove City College	4	—
Baylor University	5	37
Auburn University	6	12
Harding University	7	Not Surveyed
Rice University	Top 87	1
University of Virginia	Top 87	4
Spelman College	Top 87	18
Rutgers University	Top 87	33
University of Georgia	Top 87	35
Wake Forest University	Top 87	36
Samford University	Top 87	40
Washington and Lee University	Top 87	56
Virginia Polytechnic Institute and State University	Top 87	60
University of California, Los Angeles	Top 87	67
Clemson University	Top 87	73
Furman University	Top 87	75
Davidson College	Top 87	82
John Carroll University	Top 87	84
Stanford University	Top 87	88
University of Dallas	Top 87	90

Conference Report

The Political Economy of Bureaucracy

Public Choice literature has focused on the issue of bureaucracy, but the subject has unfortunately been neglected by the Austrian school. "The Political Economy of Bureaucracy," went a long way toward correcting that. It was sponsored by the Mises Institute and was held at the College of William and Mary in Williamsburg, Virginia, October 25-27, 1991.

As LvMI president Llewellyn H. Rockwell, Jr. noted in his introduction, the country has been invaded by bureaucrats. Each fiscal year, government at all levels sends 30 million people checks for "services" rendered on a full- or part-time basis. The federal government itself employs 3.1 million full-time bureaucrats.

Professor Murray N. Rothbard of the University of Nevada, Las Vegas spoke on the rise of the bureaucratic state in his paper, "The Political Economy of Civil Service," surveying the history of bureaucratic expansion. He clarified that under the Iron Law of Oligarchy it is inevitable that elites rule in both the private and public sectors. While the market insures that elites circulate in the market, the public sector does not, especially since only a tiny minority are subject to expulsion during elections. The elites administer government "services" in a way that benefits only the government and its connected interests. While the watchword in private business is profit, in government it is untrammelled growth. And while business advertising benefits consumers, there is no check on government propaganda which cover up the truth to bolster its own legitimacy. In showing how we came to this situation, he covered the history of government employment, hitting Lincoln, Wilson, Roosevelt, and Johnson particularly hard. He argued for a return to the "spoils" system where bureaucrats are tossed out each time the party in power changes.

Echoing similar themes in his paper "The Politics of the Managerial State," Dr. Samuel Francis of the *Washington Times* defined bureaucracy as a system of power that stands outside society's voluntary institutions and is inherently in conflict with them. He argued on behalf of James Burnham's thesis that a managerial revolution occurred this century which transformed this bureaucracy into a technocratic elite intent on micromanaging all aspects of economy, education, church, family, and culture. The paper engendered debate for his emphasis on the role private corporations have played in causing the revolution to come about.

The interaction between interest group lobbying and bureaucracy was explored by Professor Thomas DiLorenzo of the University of Chattanooga, Tennessee. Not only does the present system of government not discourage faction, but it encourages it. Environmental groups, protectionist groups, civil rights organizations, and many more, receive government money in indirect ways, which is funneled back through to reelect candidates sympathetic to their interests. This creates a cartel of politicians and non-profit group lobbyists which exercise an enormous degree of control over regulatory agencies. In turn this creates a special interest/bureaucratic nexus which hurts individual taxpayers and the economy at large.

Professor Joseph Salerno of Pace University dipped into the history of economic thought to find that few economists have had sensible ideas on the subject of bureaucracy. He criticized the Virginia School of Public Choice, because it does not provide a fundamental theoretical framework for understanding bureaucracy from the standpoint of price theory. In Mises's 1926 book *Liberalism* and his 1944 book, *Bureaucracy*, he argues that there can never be bureaucracy in the free-market private sector because the profit and loss system punishes it. The government sector has no profit and loss system, and therefore cannot calculate the best use of resources, as socialism cannot. It doesn't matter how well-intentioned bureaucrats are, they lack the tools to do their job.

Dr. Roy Cordato of the Institute for Research on the Economics of Taxation presented a paper arguing that the so-called public goods justification for bureaucratic intervention is totally fallacious. The conditions of perfect competition assure that no real-world market can meet the test, but the endurance of the model causes a pro-bureaucracy bias. He pointed out, for example, that 83% of economists favor anti-trust legislation. The Austrian school theory, in contrast, argues that much of what is objectified and static under conventional economic theory is actually subjective and dynamic in real-world markets. His theory argued that state administrators have neither the will nor the way to do what they claim to do, that is, improve the operation of the free-market economy.

Applying theory to American history, Professor Jeffrey Herbener of Washington and Jefferson College argued that bureaucratic growth occurred during critical episodes, from the civil war to the present administration. The government's strategy for growth is to create a crisis which has to be solved by more intervention. He placed a special

emphasis on the effects the growth of the state has in bureaucratizing private business. The massive regulatory apparatus of the modern state forces companies to employ more and more people whose job is not to enhance consumer welfare and profits, but rather to keep the rules and dictates issued arbitrarily by third parties. In this way, the mixed-economy of America has become less and less responsive to changes in consumer preferences and more vulnerable during recessions and depressions.

Dr. Allan Carlson of the Rockford Institute presented his paper "Sweden and Mixed-Economy Welfarism," on Sweden's decline into bureaucratic barbarism and how America is taking the same path. During the 19th century in Sweden, the family was replaced by the State. Beginning with mandatory school attendance laws and anti-child labor laws, Sweden had, by the 1980s, constructed a complete client state. They are now trying to find their way out of the miasma of welfarism and its effects, but no proposal goes far enough to take care of the problem. Although the U.S. is following a similar path—constructing the welfare state to "solve" the problems welfarism has created—the only real solution, he argued, will be total dissolution of its central tenant that the state, not the family, should be the primary caregiver.

Professor Yuri N. Maltsev of Carthage College directed his discussion to the problems of former Soviet bureaucracy. In that country (or those countries), 18.3 million people work directly as administrators of state policy, and 97% of the population works in some capacity as bureaucrats, the result of which is to redistribute 83% of the national income. Bureaucratization became much worse under the rule of Mikhail Gorbachev, contrary to public perception. It will require a radical decentralization. Maltsev also worries about the creation of what he called a Bureaucratic International, a means by which Russian and American counterparts conspire to preserve their positions of power. They have more in common with

Yuri Maltsev,
Richard Hite,
and Hans Hoppe
enjoy an outdoor
luncheon at the
bureaucracy con-
ference.



each other than with the taxpayers of their respective countries.

Concentrating on domestic bureaucrats, Dr. David Fand of George Mason University demonstrated the faulty bureaucratic thinking that led to the S&L crisis. Non-bank banks, since their inception in the 1930s, were treated with special privilege. Regular banks were thought to support big business, but S&Ls were thought to serve the poor. Moreover, regulators thought it was important to give special privileges to those investing in the real estate market, since they thought active land markets were somehow critical to preventing recession. Bad investments were overlooked and possible only because of the deposit insurance provided by government, which privatized gains and socialized losses. These conditions created opportunities for political graft and as a result the taxpayer is paying for the S&L debacle. The result will be even more bureaucracy in the banking and financial industries.

The American education bureaucracy was the subject of an attack by Dr. Thomas Fleming of *Chronicles*. American education, he said, is in a deplorable state because the autonomy of local school boards has been drastically diminished, and the role of consuming parents has been all but totally removed from the formation of curriculum, discipline, and administration. He predicted failure for any reform programs. For example, school voucher programs would end the autonomy of any private school that received them, and the same would be true of tax credits. School reform programs have been proposed and implemented every generation since the mid-19th century with no substantial effect. What is needed is radical decentralization and a total dismantling of the state education apparatus.

Professor Hans-Hermann Hoppe of the University of Nevada, Las Vegas, gave the most controversial paper, "Bureaucracy and Time Preference." He argued that increased bureaucratization lowers the time horizons of the public; property and wealth becomes less secure and people are less willing to save and plan long-term. This occurs with welfarism, which encourages short-term thinking and redistribution away from wealth holders, which reduces the amount of money invested in long-run projects. Bureaucratic interventionism leads to shorter production projects, fewer technological advancements, and reduced prosperity. Majoritarian democracy itself, argued Hoppe, tends to have a corrupting influence on the security of property. Once the right to vote is given, or even conceded, the political arena becomes the area for advancement at the expense of property

holders. Moreover, under democracy, politicians have an incentive to loot as much as they can regardless of how that affects the economy at large. He contrasted this with monarchism, under which the ruler has incentive to protect the commonwealth from mass looting in order that his children and dynasty continue as a wealthy country. The monarchy creates a consumption state—the family itself lives off the taxpayer—but that is better than democracy, which collapses into a redistributive state in which the distinction between the ruler and the ruled is obscured.

Some papers will appear in a book on bureaucracy and others will be reprinted in the series "Issues in Political Economy." ▲

Book Reviews

Money, Method, and the Market Process: Essays by Ludwig von Mises

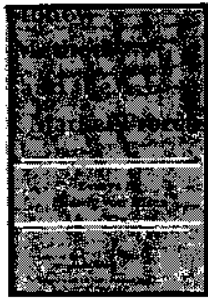
Richard M. Ebeling, editor
Boston: Kluwer Academic Publishers, 1990

Reviewed by Hans-Hermann Hoppe

Two decades after his death, all of Ludwig von Mises's major works are still in print. This success is remarkable given that except for a few years during the late 1930s in Switzerland, Mises never occupied a regular university post. He was barred from all positions of academic power in his native Austria as well as in the United States, his second home, primarily because of his principled opposition to a rising tide of intellectual relativism, represented in particular by historicism and positivism, and its political outgrowth: statist nationalism, interventionism, social engineering, and socialism.

Throughout his life, Mises relied exclusively on the power of his words—and his unwavering conviction that even the most rampant forms of statism, and the most relentless statist propaganda of a steadily growing class of "public educators" in schools and universities, could not stamp out the human desire for independent thinking, logic, and truth. Each of Mises's books is exemplary in its display of lucidity and argumentative rigor (there are few dissertations being written on "What did Mises really mean?" because Mises says what he means, clearly, and with little room for confusion). The lasting success of his books attests to the endurance of human rationality.

In light of the dramatic vindication of Mises by



the collapse of full-blown socialism across the globe (which he predicted as early as 1919), Mises and his work may at last receive their proper recognition within the academy, as one of the great intellectual heroes of our time and

the paradigm of a new age defined by a renaissance of economic reason.

The publication of *Money, Method, and the Market Process* is particularly fortunate. The volume, edited and with a knowledgeable introduction by Richard Ebeling, contains 21 articles written by Mises between 1930 and 1969, many of which are previously unpublished. For the Misesian expert, there is nothing fundamentally new in these essays—because there is no such thing as Mises I, II, or III because Mises remained consistent. Yet this volume is undoubtedly the best introduction to Misesian thought, and it rewards even the experienced Mises reader with fresh perspectives. His *magnum opus*, the monumental *Human Action*, which contains Mises's system of economic theory and social philosophy in its most fully developed form, is extremely demanding of its reader and largely inaccessible to the first-time reader of Mises. His other major books—*Theory of Money and Credit*, *Socialism*, and *Theory and History*—and his many smaller ones, only deal with parts of his system. The present work fills an important gap by offering an introduction to all major aspects of the Misesian system, including those in which Mises made his most original contributions.

The book accomplishes this task with a balanced selection of pieces, organized under five headings. In the essays assembled under "Method," Mises explains the nature of economic theory as the logic of action, or as he terms it: *praxeology*. Economic theorems are propositions that are logically deduced, or deducible, from the universal, incontestably true action axiom: "that man is in a position to choose among different states of affairs with regard to which he is not neutral and which are incompatible with each other, i.e., which he cannot enjoy together" (p. 20), and a few empirical, and empirically testable, propositions (such as that leisure is a consumption good). As the conclusions of deductive arguments ultimately derived from an incontestable axiom, economic laws are shown to be apodictic, true a priori synthetic propositions.

Historical data may provide an illustration of economic laws, but it "can neither prove nor disprove the teachings of economic theory" (p. 12). Indeed, it would involve a categorical mistake to consider economic theory as verifiable or falsifiable by historical experience. Economic theory logically precedes history and constrains historical interpretations. It restricts the range of possibly correct interpretations of sequences of historical events much in the same way as the laws of logic restrict and constrain the range of possibly correct observations.

The essays in the section on "Money" explains the function of money as a medium of exchange, and uncertainty as the necessary condition for its emergence. Mises demonstrates why the demand for a medium of exchange "presupposes an already existing objective exchange value" (p. 58), why money can only originate as a *commodity* money, and why once a directly useful barter commodity "has become money, then the specific demand for money can tie into an already existing exchange relationship between money and goods in the market, even if the demand for the money-good, as motivated by the other use, disappears," (ibid). That is, money, once established, can also be severed from its commodity origins.

Mises clarifies the categorical difference between deposit banking and loan banking; why the banking system becomes inherently bankrupt; and the cause of recurring boom-bust cycles, as soon as these two functions are no longer strictly separated. That is, as soon as deposit banks deviate from a policy of 100% reserves (as he plainly called for in his 1952 addendum to *The Theory of Money and Credit*) and loan out their deposits while retaining their contractual obligation of instant redeemability. In conclusion, writes Mises, "it is not the old classical gold standard, with effective gold circulation, which has failed; what *has* failed is the gold 'economizing' system and the credit policy of the central banks of issue."

In the section on "Trade" Mises demonstrates once again the truth of the Ricardian insight "that free trade only ensures the highest productivity of the economic efforts and that every kind of protectionism must necessarily result in a reduction of the output of capital and labor" (p. 114). He shows that "division of labor and war are incompatible" (p. 117) and, *mutatis mutandis*, why governmental restrictions on the freedom of migration, imports and exports create nationalism and international conflicts as well as lower living standards at home and abroad.

The essays on "Comparative Economic Systems" demonstrate Mises's vigor as a defender of

laissez-faire capitalism and private property, and saving and capital accumulation as indispensable to prosperity and progress. Socialism, the collective ownership of factors of production, by outlawing a capital goods market, and hence capital goods prices, makes cost accounting impossible and thus leads to permanent misallocations, capital consumption, and impoverishment. Nor is a mixed economy—a “social” market economy or welfare state system—a viable social order. For any interference with the operation of free markets invariably produces more of the same problems it was designed to cure, and hence either leads to full-blown socialism or else requires a return to free-market policies and capitalism as the only genuinely “stable” social order.

In the final section on “Ideas” Mises restates the Humean insight, which has only recently received another dramatic confirmation with the sudden collapse of the seemingly impregnable power of the communist rulers of the Soviet Union, that no government can last without majority support, be it active or passive. Once this support is gone, even the most ruthless tyrant will be toppled. In the last resort, then, the course of history and the outcome of man’s ceaseless struggle for liberty will be decided in the realm of ideas.

Reading Mises and reflecting on his life-long fight against the prevailing trends of social and economic thought I was reminded of a passage from Stanislav Andreski’s scathing attack on the sociology profession in his *Sociology as Sorcery*:

Despite the advanced stage of cretinization which our civilization has reached under the impact of the mass media, there are still some people about who like to use their brains without the lure of material gain; . . . people interested in ideas, and prepared to think them through and express them regardless of personal disadvantage, have always been few; and if knowledge could not advance without a majority on the right side, there would never have been any progress at all—because it has always been easier to get into the limelight, as well as to make money, by charlatanism, doctrinairism, sycophancy and soothing or stirring oratory than by logical and fearless thinking. No, the reason why human understanding has been able to advance in the past, and may do so in the future, is that true insights are cumulative and retain their value regardless of what happens to their discoverers; while fads and stunts may bring an immediate profit to the impresarios, but lead nowhere in the long run, they cancel each other out, and are dropped as soon as their promoters are no longer there (or have lost their power) to direct the show. Anyway, let us not despair. (p. 17)

Indeed, if the sweeping vision of the essays collected here were absorbed by a new generation of intellectuals, there is no reason for despair, but rather reason for hope. ▲

Reflections on a Keynesian Concordance

Keynes’s The General Theory of Employment, Interest, and Money: A Concordance

Fred R. Glahe, editor
Rowman and Littlefield, 1991

Reviewed by Roger W. Garrison

A concordance is more at home in literary criticism and theology than in economics. So foreign is this particular research technique to economists that many will reach for their dictionary before they get past the title page. My *Webster’s Ninth* defines concordance as “an alphabetical index of the principal words in a book. . . .” The word “principal,” though, must be understood to exclude only articles, conjunctions, prepositions and pronouns and all forms of the verb “to be.” All other words used by Keynes in his *General Theory* [2] are listed in alphabetical order together with the total number of times each is used and the identification by page and paragraph of each use. We can note, for instance that Keynes used the word “same” 209 times and the word “different” 120 times. He used the word “optimistic” three times and the word “pessimistic” only twice. Even the ifs (566), ands (2,123), and buts (496) and other “excluded” words are listed with their total word counts. This 280-page index plus a two-page preface by the editor and a two-page introduction by Kenneth E. Boulding make up the concordance.

Why a concordance of the *General Theory*?—or of any book, for that matter? A concordance is offered as a research tool, as a means to an end. A comprehensive listing of the words Keynes used may help us to understand how Keynes thought, why he believed what he did, and what his message really was. Of course, we need help in these directions only if the alternative means of reading the words in the sequence in which Keynes himself arranged them proves unsuitable for achieving these ends. Let’s give Keynes a chance to answer a few simple questions and possibly render this concordance superfluous.

Q: Please, Professor Keynes, what do you mean by “involuntary unemployment”?

A: My definition is . . . as follows: Men are

involuntarily unemployed if, in the event of a small rise in the price of wage-goods relative to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment (p. 15).

Q: Please, Professor Keynes, what governs private investment in a market economy?

A: Our conclusions can be stated in the most general form . . . as follows: No further increase in the rate of investment is possible when the greatest amongst the own-rates of own-interest of all available assets is equal to the greatest amongst the marginal efficiencies of all assets, measured in terms of the asset whose own-rate of own-interest is greatest (p. 236).

Q: Please, Professor Keynes, doesn't monetary expansion trigger an artificial boom?

A: [A]t this point we are in deep water. The wild duck has dived down to the bottom—as deep as she can get—and bitten fast hold of the weed and tangle and all the rubbish that is down there, and it would need an extraordinarily clever dog to dive down and fish her up again (p. 183).

Please, Professor Glahe, provide us with a concordance.

In 1959, Henry Hazlitt [1] provided a virtual page-by-page critique of the *General Theory*, exposing many contradictions, fallacies, and confusions in Keynes's arguments. But *The Failure of the "New Economics"* was largely dismissed by the economics profession partly on the grounds that Hazlitt was not a (degreed) economist and partly on the grounds that his focus was too narrow. The journalist-turned-Keynesian-critic, it was claimed, never perceived the underlying theme nor understood the central message of Keynes's book.

For several decades, now, Keynesian interpreters who have overlooked the problems identified by Hazlitt in order to get the big picture have gotten many different and conflicting big pictures. Well-credentialed Keynesian scholars can be found on both sides of key issues: Is the *General Theory* a continuation of the work begun in Keynes's *Treatise on Money*, or is it a revolutionary break from his earlier book? Does the so-called liquidity trap, which prevents a falling wage rate from reducing unemployment and renders monetary policy impotent, figure importantly in Keynes's case for fiscal activism, or is it only a curious extreme with no historical or practical importance? Does Keynes actually contend that the economy can be suffering from widespread unemployment and nonetheless be in equilibrium, or is he saying

that market adjustments in circumstances of economywide disequilibrium may need to be augmented with or supplanted by policy prescription? Is the assumption of fixed or sticky prices and wages critical to Keynes's arguments, or is it merely a convenient means of making those arguments? Is the standard textbook rendition of Keynesianism, which largely abstracts from problems of economic uncertainty, faithful to Keynes's theory, or is the notion that capital markets are debilitated by pervasive uncertainty an important part of his central message?

If a reading of the text-as-is doesn't resolve these questions, maybe a concordance can help. We can now be sure, for instance, that the word "trap," as in "liquidity trap," does not appear in the book. (The term was actually introduced by Dennis Robertson in a critique of Keynes's theory of interest.) However, if we cross-check the word "absolute" (16) with the word "liquidity" (44) or "liquidity-preference" (47), we find two overlaps—on pages 191 and 207. The first overlap reference leads us to a discussion concerning "the rate of interest at which liquidity-preference becomes absolute"; the second to a similar passage in which "liquidity-preference may become virtually absolute. . . ." We haven't exactly identified the true significance of absolute liquidity preference in the *General Theory*, but at least, the concordance helped us find the relevant passages.

Was Keynes an equilibrium theorist or a disequilibrium theorist? Here, the concordance provides information that would otherwise be difficult to come by. The word equilibrium is used 77 times; the words disequilibrium and disequilibria are used once apiece. A quick check of the two instances in which Keynes appended the prefix "dis-" provides no support for the claim that Keynes was interested in disequilibrium. Of course, there is still room for the claim that Keynes used the tools of Marshallian partial equilibrium analysis, which were the only tools he knew about, to analyze an economy in macroeconomic disequilibrium.

All in all, it is probably true that the very existence of this concordance tells us more about Keynes's book than even the most competent and inspired use of the concordance can tell us. The fact that there is (presumably) a demand for the concordance implies that researchers are now stopping just short of tea leaves and dream analysis in their efforts to decode Keynes's message.

Further, the fact that this concordance is being supplied carries its own message. Time-saving and cost-saving developments in computer technology

have shifted the efforts of at least one economist away from more conventional research to the production of a concordance. A digital scanner and word processor have accomplished a task that would otherwise have occupied an army of monks for many a fortnight.

The computer sorts and counts words mindlessly. Boulding notes in his introduction that the word "interest" is the second most used non-trivial word in the *The General* (103) *Theory* (225) of *Employment* (615), *Interest* (712), and *Money* (505). But two of the first ten references to the use of the word "interest," we discover, are instances where the word means "aroused attention." "Ricardo expressly repudiated any *interest* in the amount of the national dividend . . ." (p. 4, *emphasis altered*). And "Queen Victoria was a better queen but not a happier woman than Queen Elizabeth—a proposition not without meaning and not without *interest*" (p. 40, *emphasis added*).

The concordance includes entries that may puzzle idle browsers. For instance: "san (1) 355:1." This means that the word "san" is used only once in Keynes's book and that it appears in the first paragraph of page 355. Few users of the concordance will link this entry with a much earlier one: "Antonio (1) 355:1." According to Keynes, literature touting the

ideas of Silvio Gesell, whose inflationist schemes Keynes endorsed, were distributed in San Antonio.

Other, less obvious but more serious, instances of splitting a two-word name or term make the concordance less than useful that it might otherwise be. Keynes's concept of "user costs," for example, is sometimes identified as a key subjectivist insight and a link between the thinking of Keynes and the thinking of the more thoroughgoing subjectivists of the Austrian school. But "user cost" does not appear as a single entry. "User" appears 97 times; "cost" and "costs" appear 294 and 45 times, respectively. The cross-checking required to identify every instance of "user cost(s)" would be tedious.

All such problems aside, it can be said that among major twentieth-century contributions to economics, the *General Theory*—and probably only the *General Theory*—remains enough of an enigma to justify a concordance at all. Two cheers for Glahe for bestowing upon Keynes this unique honor.

References

- Hazlitt, Henry, *The Failure of the "New Economics."* Princeton, N.J.: D. van Nostrand, 1959.
- Keynes, John Maynard, *The General Theory of Employment, Interest, and Money.* New York: Harcourt, Brace, 1936. ▲



Austrian
Economics Newsletter
Auburn University, AL 36849-5301

Non-Profit Org.
U.S. POSTAGE
PAID
Auburn University, AL 36849-5301
PERMIT NO. 9