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Externalities and the State

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Abstract: Murray Rothbard and Ludwig von Mises argued that cases of negative externalities all turn out to be instances of failure of government to enforce individual property rights adequately. This article goes beyond Rothbard and Mises in claiming that failure to enforce property rights is far from the only way in which government gives rise to externalities. Indeed, rather than externalities requiring government intervention to remedy the problems they cause, this article argues that most actions of the government actually cause externalities. Looking at externalities in this way leads to the logical conclusion that government interventions are the main obstacle to markets' attaining maximum social utility. The line of reasoning leading to this conclusion is as follows: (1) government failures lead to externalities; (2) externalities lead to market failures; ergo (3) government failures lead to market failures. Specific government actions whose externality-generating effects are analyzed include taxes, subsidies, price controls, government spending, monetary policy, prohibitions, and income redistribution.

Externalities, by which economists mean social costs that exceed private costs (negative externalities) or social benefits that exceed private benefits (positive externalities), have long been a cudgel wielded by statists to attack free markets. A primary aim

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of this article is to show that externalities actually furnish a much more coherent means of critiquing government interferences with the market order than of critiquing free markets.

By applying the concept of externality much more broadly, this article aspires to enhance understanding of this concept by showing that more than being a cause of market failure, externalities are the result of government failures—in the sense of government actions frustrating the desirable results of market behavior.

AUSTRIAN VIEWS OF EXTERNALITIES

The economist most associated with using the concept of externalities, whether positive or negative, as a justification for government intervention in market transactions is A. C. Pigou (1932). Basically, the policy prescriptions set forth by Pigou and eagerly adopted by many economists were to impose taxes to raise private net costs that fall short of social net costs and to provide subsidies to raise private net benefits that fall short of social net benefits.

Ludwig von Mises saw negative externalities (i.e., external costs) as "loopholes" in "laws concerning liability and damages . . . inflicted upon other people" (Mises 1966, 655). While realizing that some of these externalities arose through inadvertent imprecision of traditional legal verbiage, Mises explicitly states that a large portion of them were results of deliberate political decisions meant to favor some interests at the expense of others. He cites examples of such deliberate loopholes being designed to favor companies engaged in investments in periods when governments sought to encourage economic growth and development, as well as differently designed policies placing greater burdens on businesses in order to favor farmers, laborers, and others of modest means (Mises 1966, 656). It follows from Mises's framing of the problem that the solution to the misallocation of resources caused by negative externalities lies not in Pigouvian taxes, but in "a reform of the laws concerning liability for damages inflicted and [in] rescinding the institutional barriers preventing the full operation of private ownership" (Mises 1966, 658). Save for his omission of the difficulties in implementing this solution caused by transaction costs (Coase 1937; 1960), Mises foreshadowed modern critiques of Pigouvian tax strategies.

Whereas Mises recognizes the problem of negative externalities, although he comes up with a different solution to it, he gives short shrift indeed to positive externalities, or, as he calls them, external economies. He sees the case of positive externalities not as Pigou sees it—as "simply the inversion of the case of external costs"—but rather as a nonproblem that "is entirely misinterpreted in the current pseudo-economic literature" (Mises 1966, 658). His critique of the Pigouvian government solution of either providing subsidies or having the government run such projects at a loss is that it ignores the opportunity costs of such expenditures (Mises 1966, 639). Although the phrase had not yet been used when Mises wrote, it is safe to say that he would have seen positive externalities as an example of what Harold Demsetz (1969, 1) dubbed the "nirvana" approach: faulting an existing "imperfect" situation for not measuring up to a perfect but nonexistent norm.

An additional Achilles' heel for the concept of externalities is its failure to apply subjectivism, a pillar of the Austrian approach. Rothbard (1956) clearly lays out the inability, due to the invalidity of interpersonal comparisons of utility, to determine whether any government action is an unalloyed benefit. Closely related to this point is that the subjective nature of value makes the measurement of the external costs or benefits referred to as externalities impossible. If governments cannot measure the magnitude of the externalities they are "correcting," they will be unable to implement proper corrective measures for them in practice, no matter how appealing the idea of externalities may be in theory.[1]

More recent scrutiny of Pigou's writings (both the previously cited *The Economics of Welfare* [Pigou 1932] and his 1935 essay "State Action and Laisser-Faire" [Pigou 1935, 107–28]) by Steven Medema (2010) and Michael Munger (2018) unearths a largely neglected part of Pigou's thinking which casts a long shadow of doubt over his more interventionist policy prescriptions. Both Medema and Munger cite Pigou's mention of information and incentive problems—in Pigou's words, "information problems faced by, and the pressures brought to bear on, governmental agents" (Pigou 1932, 331–32)—which may lead to much unnecessary government action.

[1] This point is also made by Stephen P. Halbrook (2003).

One final argument against the Pigouvian taxation-subsidization solution which I had not previously encountered in the literature on externalities is that it takes more than merely social costs or social benefits that differ from their private counterparts to make an action an externality. A prerequisite for making something an externality, or at least making it actionable by taxation-subsidization, is the presence of a property-rights violation. Donald Boudreaux makes this crucial point in his discussion of anti-COVID policies, stating that "a genuine externality exists only when there is a violation of someone's property rights." He goes on to conclude that "the relevance of the distinction between third-party effects that violate someone else's property rights and third-party effects that don't is especially crucial today" (Boudreaux 2021).

The thesis of this article goes beyond these points to look at situations in which no externalities currently exist—that is, those in which private costs equal social costs and private benefits equal social benefits. These situations are textbook examples familiar to all economists. However, they analyze them from the perspective of deadweight loss rather than that of private versus social costs and benefits. Looking at them from the latter point of view clarifies how government interventions actually create externalities where there had previously been none. This case has been made once before, to my knowledge, by Austrian economists William Barnett II, Walter Block, and Jerry Dauterive (2010), who organize their examples around the categories of socialization of risk and government's undervaluing of the time and other resources of its citizens.[2] While the examples here are somewhat wider and less specific than theirs, this article's conclusions largely coincide with theirs. The finding in case after case is a diversion of production from the assortment of goods most desired by consumers.

Some would argue that this muddies the waters between externalities and deadweight-loss-inducing government actions. A valid counterargument is that the common distinction economists make

[2] Barnett, Block, and Dauterive (2010, 217) write, "This paper is devoted to an examination of cases where government is guilty of imposing external diseconomies on the populace. Given (the contrary to fact conditional) that externalities are a coherent concept, we shall demonstrate that in carrying out its duties, government imposes harm on third parties."

between externalities and deadweight-loss-inducing government actions is itself artificial. Furthermore, even worse than being artificial, that distinction has the unfortunate consequence of obscuring the fact that government interventions create the very class of problems which they are putatively intended to remedy, thus justifying more such interventions.

To understand who bears the spillover costs or forgoes the spillover benefits from government actions when analyzed through the perspective of externalities, it is useful to start by analyzing the winners and losers from a classic negative externality not caused by government intervention—the case of water pollution. The beneficiaries of the water pollution that results from a particular production process are those firms (and their stockholders) who receive profits they would not have earned had they been compelled to bear the costs of the water they made unusable to others by polluting it. Those harmed are all who suffer direct, palpable harm from using the polluted water and those who have to spend resources treating the water to prevent themselves from suffering that type of harm. The beneficiaries of the water pollution externality are violators of property rights.

The eight cases discussed below have some very different configurations of who gains and who loses. However, a key commonality between this classic case and the eight cases in the next section is that all of the cases' beneficiaries are violators of property rights.

GOVERNMENT ACTIONS THAT CREATE EXTERNALITIES: A TAXONOMY

How do government actions create externalities? In the following cases, marginal social costs initially equal marginal social benefits.[3]

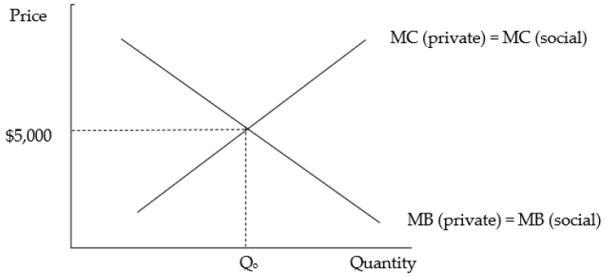
[3] I recognize that it is theoretically possible for there to exist cases where an existing imbalance between social and private costs could be remedied by some of these Pigouvian interventions. I also believe that these imbalances are far less common than is generally supposed by most economists. Daniel F. Spulber (2002) has put together an anthology in which he catalogues a number of cases in which the evidence supporting the existence of market failures in need of governmental remedies has been greatly exaggerated, if not made up entirely. Externalities, including public goods—an extreme case of positive externalities—are well represented among these cases (Spulber 2002, 4, table 1.1).

How do government interventions affect this cost-benefit relationship? The following sections explain.

Excise or Sales Taxes

These taxes create a "wedge,"[4] raising private cost to the buyer and reducing private benefit to the seller. What is this "wedge" but an externality? Assume a new refrigerator has a market-clearing price of $5,000. At this price, the ex ante marginal cost of the refrigerator would be no more than $5,000, and the marginal benefit to the marginal buyer would be at least $5,000 (figure 1a). In this situation, all refrigerators produced would be valued by buyers at more than the opportunity costs of bringing them to market. In other words, the socially most desirable quantity (Q_o, the optimal quantity) of refrigerators would be produced.

Figure 1a. Equilibrium with No Externalities

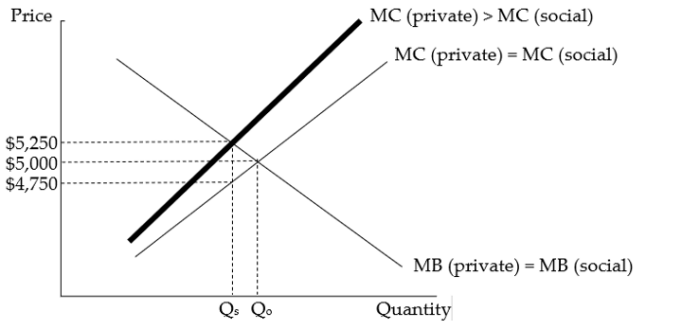


The imposition of a 10 percent sales tax on the refrigerator (figure 1b) alters this desirable situation. The tax, ceteris paribus, will raise the price paid by the buyer after the tax by up to $500 (10 percent of $5,000) and reduce the amount received by the producer net of the tax by up to $500 less than the incremental

[4] "The difference between what it costs a firm to employ a worker or acquire a unit of capital and what the worker or saver receives net is the tax wedge" (Laffer 1981, 29).

increase the buyer pays.[5] The marginal private cost to both producers and consumers of refrigerators is now higher than the marginal social cost, the very definition of a positive externality from the viewpoint of both buyers and sellers. This $500 wedge incentivizes producers to offer for sale and consumers to bid to buy fewer refrigerators than in the pretax situation (figure 1a), diverting resources from refrigerators to nontaxed items. The quantity of refrigerators is now suboptimal (Q_s, suboptimal quantity), meaning that fewer refrigerators than the socially optimal quantity will be produced. Thus, this tax creates an externality which reduces general welfare.

Figure 1b. Pre- and Postequilibrium with 10 Percent Sales Tax



It may seem counterintuitive to call this a positive externality, but in basic Pigouvian analysis, positive externalities imply that too few of the affected goods are being produced—the very result we have here. The solution Pigouvian analysis calls for in this case is a subsidy on refrigerators. Obviously to both tax and subsidize the same product would be silly. However, if you consider a subsidy as a negative tax, the subsidy effectively eliminates the tax that caused the externality in the first place. This is consistent with the basic Pigouvian policy prescription for externalities. However, the point is that if an externality does not exist, imposing a tax creates one.

[5] In the example shown above, the tax burden happens to be split evenly between buyers and sellers. Changes in the relative slopes of the supply and demand curves will alter the relative burden of the tax.

With a sales tax, the beneficiaries are the state that collects the tax and those bureaucrats and contractors who receive jobs and business through the additional tax revenue (assuming they are on the low-rate part of the Laffer curve where higher tax rates generate higher tax revenues—otherwise, they suffer harm).

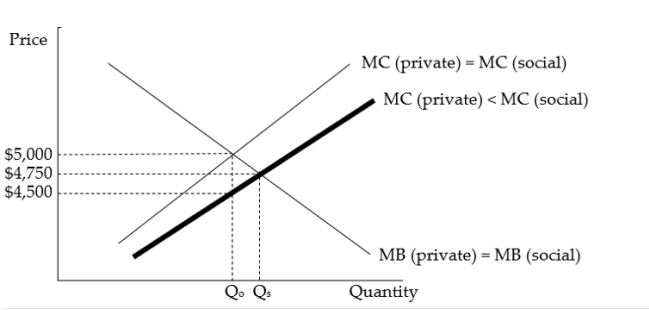
The forgone benefits (i.e., the positive externalities) are borne by both buyers and sellers of the taxed product. The marginal buyers are denied the opportunity to purchase the taxed good at all, thus forgoing the net benefit they would have received from it. The inframarginal buyers, who are still better off buying the product at the new, higher price than not buying it at all, are denied the benefits they would have received from the additional money they must now pay for the tax.

On the producer side, marginal sellers will have to cease producing the taxed good lest they suffer losses on it, forgoing all potential profit on it. If that is their only output, they will be driven out of business. The inframarginal producers, who have to cut back output and earn less profit on the units they continue to produce, are denied only some of their profit rather than all of it.

Subsidies

Subsidies, in which the state makes grants of money to (as opposed to charging a sum of money from) those engaged in certain transactions, can for the most part be analyzed as negative taxes. As such, they reduce private costs to the recipient of the subsidy, creating negative externalities. Continuing with the refrigerator example, the subsidy is given to the producers at 10 percent of the original price (figure 2).

Figure 2. Pre- and Postequilibrium with 10 Percent Subsidy



As shown in figure 2, sellers will pass part of the subsidy on to buyers yet maintain their profit margins and sell a larger quantity. This larger quantity is now suboptimal (Q_s) as it will lead to overproduction of refrigerators, diverting resources from other, more beneficial uses. This misallocation of resources is an example of a "market failure" created by subsidies. Since more than the socially optimal quantity of refrigerators is now produced, government has created a negative externality. Once again, rather than externalities creating a need for government action, government action is creating externalities.

While subsidies are negative taxes, certain asymmetries between private and state sectors make the effects of subsidies not exactly the inverse of the effects of taxes. Although the state spends additional money to subsidize activities, those running the state perceive the benefits of these subsidies to exceed those of the alternative uses to which they could have put that money. While subsidies lack the additional patronage opportunities inherent in higher taxes, they nonetheless buy votes from the patrons of the industries subsidized and campaign contributions from the industries themselves.

Consumers who receive the subsidies receive more of the subsidized good than they would have been willing and able to pay for out of their own pockets. The failure to pay the full costs of what they consume by passing those costs on to others is a negative externality created for them by the government. Similarly, producers who receive the subsidies do not bear the full costs of their activities.

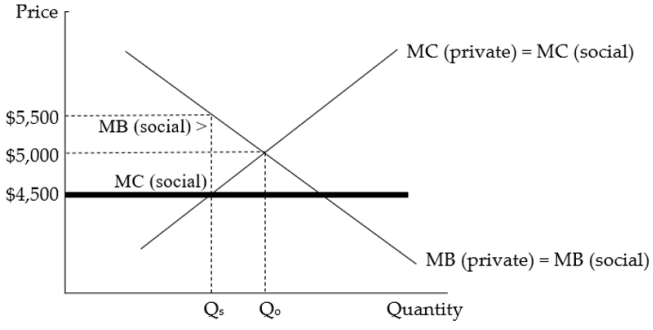
The forgone benefits are borne by both buyers and sellers of nonsubsidized products who neither buy nor sell the subsidized products. Buyers of only nonsubsidized goods will find the goods they desire to be higher-priced because the resources that would have been used to produce them have been diverted to the subsidized sector while at the same time the financing of those subsidies through taxes and/or money creation reduces the buyers' own purchasing power. This combination of factors puts a profit squeeze on producers of nonsubsidized goods, forcing most to reduce output and some to close down altogether. To both of these groups, the externality created is a positive one, as some of the spillover benefits from private production are no longer available to them.

Price Ceilings

With market-determined prices, private costs equal social costs for both buyers and sellers. A price ceiling (a legally enforced maximum price) reduces private benefit to the seller so that it becomes less than the social benefit to the buyer, incentivizing sellers not to offer as many refrigerators for sale. At the same time, this enforced maximum reduces the cost, both private and social, to the buyer while, in the short run at least, leaving the private and social benefits to the buyer unchanged[6] (figure 3). Both these changes create deficient supply/excess demand for the product subject to the ceiling. Since consumers cannot purchase that which is not offered for sale, the response of the sellers to the price ceiling dominates. This means that fewer refrigerators are produced and offered for sale. The artificial lowering of benefits to sellers below the social benefits of providing such goods will push resources out of refrigerator production and therefore into production of less desired goods, again a net loss to society. Thus, price ceilings create positive externalities, with their characteristic production of a suboptimal quantity (Q_s) of the good subject to those externalities.

[6] Over time, sellers who remain in the market will make a futile effort to maintain their profit margins by cutting corners on the quality of the product or reducing the size of the product in a way they hope will be imperceptible to both buyers and enforcers of the price ceilings, thus reducing the benefits to the buyers.

Figure 3. Pre- and Postequilibrium with Price Ceiling



Price ceilings are imposed with the *unstated* goal of aiding the government at the expense of everyone else. The trick here is for the government to announce good intentions that lead to disastrous results and then to convince people that someone else is to blame for the bad results while it takes credit for the good intentions. Telling people that they can have more of specific goods for less money is a sure vote-getter when the level of most people's economic knowledge is abysmal ignorance. Thus, the government reaps benefits without bearing the full social costs of its actions, a negative externality.

Price ceilings deny all sellers benefits that they would have obtained in a free market, a positive externality. The marginal sellers whose costs exceed the ceiling price will have to cease production, thus forgoing all profits they would otherwise have earned from that product. The inframarginal sellers will sell less output and will earn less profit on each unit sold than they would have at the market-clearing price.

A small subset of buyers, namely those who can still obtain the product at the ceiling price, will receive the gratuitous benefit of not bearing all of the costs of the product they receive, a negative externality. For all other potential buyers, the externality created by the price ceiling is positive, as they are denied access to a previously available product.

Price Floors

Price floors also create a misallocation of resources, although in the opposite direction as that created by price ceilings. Again, while

market-determined prices cause private costs to equal social costs for both buyer and seller, a price floor (a legally enforced minimum price) drives private benefit to the sellers higher than the social benefit, thus incentivizing them to offer more for sale. At the same time, the enforced minimum will increase the private and social cost to the buyer. Both these changes create excess supply/deficient demand for the product subject to the floor (figure 4a). Because sellers have no reason to offer for sale that which will not be purchased, they will respond to the price floor by producing and offering fewer refrigerators for sale. The artificial raising of costs to buyers above the social costs of providing the goods will push resources out of refrigerator production and therefore into production of less desired goods, again a net loss to society. Interestingly, this has the same allocative effect (a positive externality) as the price ceiling example, with only the distributive effect between buyers and sellers differing. However, an additional reaction occurs in the case of price floors.

Typically, governments maintain price floors by purchasing the products otherwise unsold at the controlled prices.[7] As a result, the sellers can sell all the products they find profitable at the higher price, with government buyers now supplementing the purchases of private buyers (figure 4b). This makes the externality a negative one, with suboptimal output Q_s exceeding the socially optimal level Q_o.

[7] The two best-known examples of this are governments purchasing overproduced crops to maintain price floors and making transfer payments to those who lose their jobs as a result of minimum wages.

Figure 4a. Pre- and Postequilibrium with Price Floor without Purchase of Surplus by Government

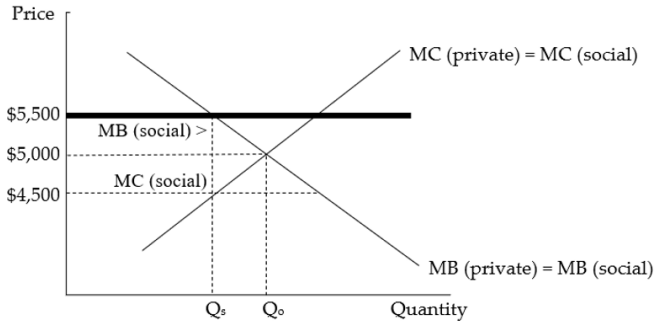
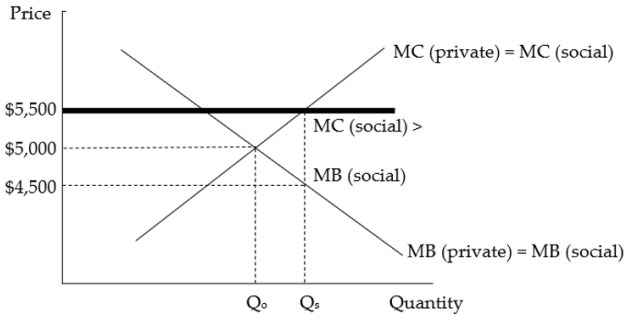


Figure 4b. Pre- and Postequilibrium with Price Floor with Purchase of Surplus by Government



Price floors, like price ceilings, are imposed with the unstated goal of aiding the government at the expense of everyone else. As with price ceilings, the government successfully blames someone else for the disastrous results of the good intentions for which it takes credit. Telling people that they have a "right" to receive more than the market price for what they are selling is expected to win the votes of the vast majority, who are incapable of economic reasoning. In this case it is buyers who suffer the positive externality of being denied by price ceilings benefits that they would have reaped had they been

allowed to operate in a free market. The marginal buyers have to do without the product now priced out of their reach, while the inframarginal buyers will buy less but pay more for each unit purchased.

As for sellers, the small subset of them who can still sell all they wish to at the floor price will reap the spillover benefit of receiving a higher price for each unit of the product in question, a negative externality. This subset actually becomes larger if the government does step in and purchase the surplus output produced. For any remaining potential sellers, the externality created by the price floor remains positive, as they are denied the opportunity to sell as much of their product as they would have at the market-clearing price.

Government Expenditures

Almost all government output that people might benefit from is delivered outside of the price system. As a result, government output is never sold at an equilibrium price that in the normal course of events would reflect the social costs of those goods and equate them with their social benefits. And government output is almost never[8] *directly* paid for by the ultimate consumer. It is no accident that the intricacies of the tax code hide the cost each taxpayer bears for any specific government program. By reducing taxpayers' awareness of the costs they bear, this tactic mutes public resistance to overproduced services, permitting negative externalities to arise. Even though individuals *do* pay for such government output through taxes, the *marginal* cost to them of *specific* expenditures is imperceptible. Thus, the private cost subjectively perceived by all taxpayers is smaller than its social cost, which consists of the resources diverted from production of goods they would have valued more than the output the government actually produced. This result is even stronger in cases in which the purported "benefits" of government output are perceived to be negative. Foreign policy adventurism, for instance, is something that many people are opposed to. This means it is produced despite having high social cost but private benefits near or less than zero.

[8] The principal exceptions to this generalization are state colleges and universities, government-run public transportation (trains, buses, and subways), toll roads, and mail delivery. But because all of these, except in some cases toll roads that are taxed to subsidize mass transit, are subsidized, they too create externalities.

Government transfer spending similarly creates negative externalities, largely as a result of moral hazard, defined as "a situation in which one party engages in risky behavior or fails to act in good faith because it knows the other party bears the economic consequences of their behavior" (Depersio 2021). In other words, the social costs of the risky behavior engaged in by these parties exceed the private costs—the textbook definition of negative externalities. Government transfer spending leads to the same consequence as the theory of negative externalities—that too much of the risky action is engaged in.

Rowell and Connelly (2012, 1066) elucidate this point regarding various welfare-state programs as follows:

> Thus, from its earliest appearances within the economic literature, the concept of moral hazard was not limited to the analysis of private markets for insurance. For example, Rubinow [1875–1936], who was trained as a physician and then as an economist, argued that the concept of insurance could be extended to include a variety of compulsory state schemes (Rubinow, 1904). The implications of moral hazard in this form of insurance were implicitly recognized.
>
> > The one great objection most frequently raised against compulsory state insurance, either sickness or for accidents is that workingmen abuse the system, which leads, of course to greater expenditures. (Rubinow, 1904, p. 371)

They then proceed to specify unemployment insurance, worker's compensation, and disability benefits (Rowell and Connelly 2012, 1068) within this same framework. Other government transfer programs, ranging from the means-tested Temporary Assistance for Needy Families (TANF) and Medicaid to age-based programs such as Social Security and Medicare, to the political donation–based bailouts of too-big-to-fail banks and other corporations, also create incentives that generate behavior at odds with the results these programs claim to try to achieve.

Monetary Policy

Not only does government spending create externalities, but so does the government's financing of that spending through monetary policy, which is basically the creation of fiat money. When the supply

of money was set through the market process (i.e., through the mining and minting of gold), the social and private marginal costs of money were equal. The producer of new gold had a choice of whether to use the gold as a consumer good, a producer good,[9] or money. The decision of how to use newly mined gold was made at the margins by the owners of that gold based on which of the possible uses offered them the maximum subjective value. In this case, there should be no discrepancy between social and private cost or benefit.

Central banks, on the other hand, are not subject to the need to engage in a productive process in which money creation is the best use of scarce resources. They create money from resources of far lower value than the money they are used to create; the difference between the values is known as seigniorage. As Mises correctly points out, creating this new money adds nothing to social utility.[10] In other words, central banks create money which gives them, as well as those to whom they lend it early enough, purchasing power at the expense of the purchasing power of the rest of society. Central banks receive that benefit without having to bear the cost of providing something of value for that purchasing power, a classic negative externality. They have basically created money "out of thin air," which is counterfeiting (Rothbard 1990, 56).

Those who receive the newly created money later in the process see a loss in the benefit of the purchasing power they would have enjoyed absent the money creation.[11] The social benefit derived from the use of money is thus denied to them by expansionary monetary policy, making it a positive externality.

[9] For instance, gold may be used as a consumer good in jewelry, medals, and dental fillings; and as a producer good in aerospace as a lubricant coating the insides of space vehicles and in computers as an electrical conductor (Sepanek 2012).

[10] "Production goods derive their value from that of their products. Not so money; for no increase in the welfare of the members of a society can result from the availability of an additional quantity of money" (Mises 1980, 102).

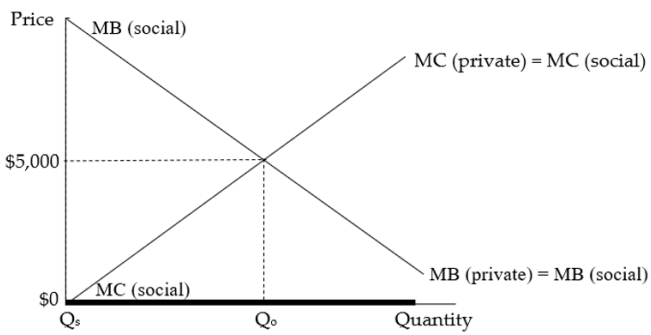
[11] This phenomenon is referred to as the Cantillon effect, developed in Cantillon (2010). Also see Thornton (1999, 24).

Prohibitions

Prohibition can be modeled as an extreme form of price control[12] because setting a price ceiling on a product at zero basically amounts to a legal prohibition of that product.[13] In figure 5 we see the effects of this policy. The goal of preventing the banned product from being sold now creates a positive externality which causes the suboptimal quantity (Q_s) of zero to be sold. Assuming that there are low or no fixed costs for the product, the marginal social benefit of that first unit would far exceed the marginal social cost of the unit.

Prohibition acts in the same direction as a price ceiling for sellers, who are denied all the profits they would have earned by legally selling the prohibited product, making it a positive externality for them. However, buyers no longer have an opportunity to purchase the prohibited product at a lower price, but are instead entirely denied access to a previously available product, making it a positive externality for them as well. In brief, prohibition denies everyone the social benefit of market exchange in that product.

Figure 5. Prohibiting Purchase of a Product By Setting Its Price at Zero



[12] Murray Rothbard (2009, 1086) describes both price controls and prohibitions as triangular interventions in *Power and Market*.

[13] It would still be possible to produce the good legally and give it away for free, possibly bundling it with a legal good so as to circumvent the control. This would simply be a black market for the banned good, similar in nature to the black markets that arise under nonzero price ceilings.

Redistribution of Income and Wealth

There is little left to say of the externalities generated by government policies to redistribute income and wealth. Each of the first seven types of government policies discussed has the impact of redistributing income. Indeed, they exhaust the ways in which government can redistribute income. If each of them creates externalities that divert production of goods and services from their optimal levels, the only way redistribution in general could fail to generate externalities would be if these seven methods of redistribution could, by some great coincidence, all cancel one another out. The probability of that would be as low as the probability of an election between two candidates with a million voters ending in an exact tie. Indeed, given that the redistribution tends to go in only one direction—from the general public to the government itself and to its donors—the probability is effectively zero.

CONCLUSION

The belief that government action is necessary to prevent market failure caused by externalities has far less validity than is commonly believed by members of the economics profession. Indeed, the opposite of that belief is much closer to the truth. Externalities are omnipresent whenever government intrudes into human affairs. Most externalities are the result of government actions. Furthermore, while some of the externalities commonly seen as market failures are indeed the consequence of property-rights violations, *all* of the externalities shown in this article result from government action are based on property-rights violations.

Virtually every type of government intervention fits the standard definition of an externality. Rather than government intervention being necessary to overcome market failures by forcing market actors to "internalize externalities," such intervention is in fact the cause of most market failures. This article comes to the same conclusions as Rothbard does in *Man, Economy, and State* (2009) and "Toward a Reconstruction of Utility and Welfare Economics" (1956).[14]

[14] "We conclude therefore that no government interference with exchanges can ever increase social utility" (Rothbard 1956, 31).

Mises (1974), in his talk "Middle-of-the-Road Policy Leads to Socialism," sees many of the specific interventions[15] analyzed in this article as creating externalities (he does not use that word, but rather refers to them as "unintended consequences," a most charitable characterization given the persistence which with these effects occur yet almost never cause governments to consider discontinuing such interventions). What is more, he also sees the interventions as generating a type of "multiplier" effect in that they attempt to remedy the problems caused by the first intervention not with a repeal of the initial intervention, but rather with another intervention, thus multiplying the externalities caused thereby (Mises 1974, 23–24).

Externalities are little more than wrong incentives enforced by violations of property rights. Yes, private actors can take harmful actions based on the wrong incentives created by incompletely defined property rights. Yet virtually every action of the government skews incentives at least as perversely as the externalities that most economists identify as sources of market failure. The contribution of this article is to turn the mainstream concept of externalities on its head and see it for what it is—a result of government intervention rather than a valid rationale for such intervention. Looking at externalities in this way leads to the logical conclusion that government interventions are the main obstacle to markets' attaining maximum social utility. The line of reasoning leading to this conclusion is that (1) government failures lead to externalities; (2) externalities, by frustrating the normal functioning of markets, lead to market failures; ergo (3) government failures lead to market failures.

The libertarian financial advisor Harry Browne once said that "government was good at one thing: it knows how to break your legs, hand you a crutch, and say: 'See, if it weren't for the government, you wouldn't be able to walk'" (Browne 2002). He did not live long enough to read this article, but this quote encapsulates its conclusion well. The government claims to be able to provide a remedy for externalities, "permitting you to walk," while everything it does purportedly to achieve that goal creates more externalities, which are what made it harder for you to walk

[15] Mises (1974) explicitly carries out a similar analysis of price controls, both ceilings (11) and floors (27); taxes (32); and monetary policy (27).

in the first place. This author's hope is that the ideas set forth in this article will reduce such interventions by removing one very popular rationale for them, though this hoped-for result seems very unlikely to be achieved any time soon.

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