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On Ronald Coase as political economist and ethicist

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Abstract:

Despite Coase's many and important contributions to economics he has mislead the profession of economics with his work in social costs, for which he is perhaps most famous. If his analytic model were incorporated into the actual practice of law, this would undermine the rule of law and private property rights, and, with them, all hope for prosperity and economic growth. In addition, his views on this topic are manifestly unjust. This all stems, in the present analysis, from Coase's inability to make a distinction between peaceful cooperation and initiatory violence, the most important one in all of political economy and ethics.

Ronald Coase

Key words:

Private property rights; transactions costs; coercion; law and economics; justice

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On Ronald Coase as political economist and ethicist¹

I. Introduction

The present paper is devoted to a critical examination of two of the publications of Ronald Coase (1960, 1974). But, before I begin my criticism, I should like to put into some sort of context the tremendous contribution to our discipline made by this man.

So far, since the Nobel Prize in economics was inaugurated in 1969, almost four score winners have been thus anointed. Needless to say, Coase is amongst that number. Thus, if this were all there were to his acknowledged contribution, his reputation would be secure, and, presumably, for all time, or, for at least as long as there are people who appreciate economics.²

But there is more, far more. For amongst all the 74 scholars who have been distinguished in this manner, only 21 of them have been awarded the prize on a solo basis. All the others shared their award with one or in a few cases two others. Coase, to be sure, is also amongst that smaller number. I would add that even of these 21, Coase sticks out as one of only a round dozen whose names are remembered not only for being on the Nobel Prize winner list, and not only by virtually all economists, but also by most business journalists, professors in other fields not limited only to social science, and indeed, to all “high information” voters in the entire world. I would include in this smaller honor roll³ the following: 1970, Paul Samuelson; 1972, Kenneth Arrow; 1973, Wassily Leontief; 1976, Milton Friedman; 1981, James Tobin; 1982, George Stigler; 1983, Gerard Debreu; 1985, Franco Modigliani; 1986, James Buchanan; 1987, Robert Solow; 1991, Ronald Coase; 1992, Gary Becker.⁴

Is it possible to single out Coase for even further distinction even amongst this very famous group? Yes, it is. How many of the Nobel Prize winners are responsible for setting up their own sub-discipline of economics? This achievement applies to Coase, certainly, for law and

¹ I thank Julio H. Cole for helpful comments on an earlier version of this paper. The entire responsibility for all errors of course lies with me.

² I am assuming, arguendo, that winning the Nobel Prize in economics is correlated with making an important contribution to our profession. There must be few economists who would dispute such a contention. This, thus, is an objective measure. There can be no dispute as to who won a Nobel Prize in economics, and who did not. It must be acknowledged, too, that not all of the 74 Nobel Laureates in economics were actually economists. For example, Ostrom was a political scientist, Nash a mathematician, Kahneman a psychologist. Nevertheless, these non-economists were judged by the Nobel Prize committee to have made major contributions to our discipline, not to their own.

³ I am limiting this to solo Nobel Prize winners in economics. If we included all such winners, even those who shared their prize with others, one would have to include Stiglitz, Krugman, Nash, Samuelson, Hicks, Smith, Fogel, North, Myrdal and Hayek. Full disclosure here: this rating is not based on any formal poll. This is merely my own opinion. And, yet, I flatter myself that this listing, or something very much like it, would be widely agreed upon by all and sundry.

⁴ Full disclosure here: this is again not based on any poll. However, I must acknowledge, Coase is not on this following list: <http://www.thefamouspeople.com/economists.php>. But this collation of “famous economists” includes “A renowned French philosopher, social activist and religious mystic, Simone Weil (who) is recognized for her strong social commitments and extensive analysis of various attributes of the modern civilization” and “June Carter Cash ... a prominent American singer, songwriter, actress and author. She was born to Maybelle Addington Carter and Ezra Carter into the renowned Carter Family (a traditional American folk music group).” Thus one hardly knows what to make of this compilation.

economics. In like manner Vernon Smith can take credit for experimental economics. James Buchanan is the father of public choice economics.⁵ Is there anyone else? Not really. Milton Friedman is perhaps known as the father of monetarism, but this is hardly a sub-discipline of our profession.

There is yet one more distinction that Coase and only Coase can claim: there is such a thing as the “Coase theorem.”⁶ People may dispute what this means,⁷ and, whether or not there really is any such thing, but there is no “Friedman theorem,” or “Hayek theorem” nor is any other economist singled out in this way.⁸

Ronald Coase has made many specific and enduring positive contributions to political economy. I would list under this rubric his work on selling titles to property in the electronic spectrum (Coase, 1959) and his views on the importance of competition in the market for intellectual ideas (Coase, 1974A, 1977).

However, he is perhaps most famous for his analysis of social costs, and secondarily for his work on the lighthouse, and here I maintain his offerings are wrong-headed, problematic and even pernicious. Why do I offer this criticism? It is because, I claim, there is a lacunae in the intellectual armament of this otherwise exemplary economist: he seems unable to distinguish between market transactions which are voluntary and based upon private property rights on the one hand; and on the other hand transactions that are anything but voluntary; that is, ones that are coercive. In particular, he confuses government, which is based on coercion, with free markets, where it is strictly forbidden.⁹

According to that old joke, someone is asked, "Do you know the difference between a bathroom and a living room?" If the person says he does not, the retort is: "Well, then, don't come to my house." In like manner I ask of Ronald Coase, "Do you know the difference between the initiation of violence and the absence of the initiation of violence in a political context?" Since I am writing this essay, I take the liberty of answering this question in his behalf, and the answer I supply to him is a resounding "No." I then respond to this Prof. Coase with whom I am having this repartee as follows: "Well, then, don't get into political economy." And I continue: this is because the distinction between an action that violates the non-aggression principle (NAP) and one that does not, that is, the distinction between the initiation of violence and the absence of the initiation of violence, is at the very core, it constitutes the very foundation of, political economy. Indeed, it is but a slight exaggeration to say that political economy consists of virtually nothing else than this distinction, and the logical implications of it.

⁵ But he has to share, in my opinion, parentage with Gordon Tullock, even though the Nobel Prize committee didn't quite see matters in this way.

⁶ Coase did not accept this nomenclature (Lee, 2013) but that is entirely a different matter. No one else in economics was in a position to accept or reject a “theorem” with his name attached to it.

⁷ For example, Cheung, 1973; Daly, 1995; Ellickson, 1991; Friedman, undated; Gillies, 1994; Gjerdingen, 1983; Halpin, 2007; Harris, 2002; Hurwicz, 1995; Maeda, 1995; McCloskey, 1998; Posner, 1972, 1993; Samuelson, 1995; Williamson, 1995

⁸ To be sure there is also a “Nash equilibrium,” and that this may well be the equivalent of a Coase theorem.

⁹ If any force or fraud or the threat thereof appears in what is otherwise ostensibly a free enterprise system, this is not true, at least to that extent. See on this Rothbard, 1973, 1982.

It cannot be denied, however, that "political economy" are practically Coase's middle two names. He may not have invented political economy, but there are few political economists who have contributed more fully and profoundly to this discipline. It is fair to say that Coase is the father of law and economics, in addition to being an early editor of the scholarly journal that launched this area of study, *The Journal of Law and Economics*. Unhappily for this field, it is for the most part predicated on Coase's failure to make this vital distinction. In the present essay I shall attempt to demonstrate this claim based on two different articles of his. In section II we will consider Coase (1960) in this regard. Section III will attempt to make this point via his work on the lighthouse (Coase, 1974B). We conclude in section IV.

II. Social Costs

Coase (1960) is the most widely cited¹⁰ of all contributions to the dismal science¹¹ (Landes and Posner, 1996; Shapiro, 1996, p. 751; Shapiro and Pearce, 2012) so it is clear this article has had a profound effect upon the profession, unfortunately. Why unfortunately?

For Coase, there are two different types of scenarios. One is the zero transactions cost model. Given this assumption it matters not one whit for the allocation of resources which of two contending parties is awarded property rights under dispute in a lawsuit. Suppose there is a rancher whose cattle roam and eat the neighbor's corn. It would cost \$100 to build a fence to ensure this occurrence does not take place. Should the farmer or the rancher be compelled to undertake this expense? For Coase, it all depends upon the relative harm.¹² Suppose that the corn eaten is worth \$40. If the judge awards the property rights to the rancher,¹³ that will be the end of the matter. He will not build it, and the farmer will have no incentive to pay him off to do so. It would be silly, it would be counterproductive, it would not be wealth enhancing, to spend \$100 in order to save \$40. If a single firm owned both the ranch and the farm, the proprietor would not build that fence, at least not if he wants to maximize profits.

Now posit that the court finds in favor of the farmer, and orders the rancher to build the fence so as to keep his cows to himself. The cattleman will offer the corn grower an amount above \$40 and below \$100 to permit his cows to run loose on the fields of the latter, for example, \$75. If so both parties gain. The cattleman profits to the tune of \$25, because he saves himself the \$100 cost of the fence building by paying the lesser \$75 to the farmer. The agriculturalist also improves his wealth position by \$35, since he is paid \$75 to overlook damages of \$40. So it really does not matter what the jurist finds; the fence will not be built in either case.¹⁴ Of course, the wealth positions of the two disputants will vary with the judge's ruling. In the first instance,

¹⁰ I do not at all mean by this that "Coase (1960) is the most highly cited of all *his*, that is, Coase's contributions to economics." Rather, I am reporting that Coase (1960) is the most highly cited article of all articles that have ever been published in the professional journal literature of this profession.

¹¹ Carlyle coined this phrase in defence of slavery, and used it as an attack against economists. See on this Dixon (1999).

¹² For him, there is no such thing as initiatory violence and/or victimization; there is no possibility of trespass. Yes, the wandering cows eat the corn, but if the corn were not there, this could not have occurred. Therefore, there is no blame attached to either party in preference to the other.

¹³ The right to insist whether or not someone will be compelled by law to invest in the fence.

¹⁴ Obviously, if the fence cost \$100, but the damages were, say, \$150, then the fence would be built, again, disregarding the judicial decision.

the farmer loses \$40. In the second case, he does not. Coase, not unreasonably, assumes profit maximizing behavior on the part of all plaintiffs and defendants.¹⁵

Next, consider the high transactions cost model. Here, transactions costs are higher than any of the values so far considered, so no bribery, or post judicial rearrangement of property rights, is feasible. Now, Coase correctly maintains, the judge's decision will indeed determine the allocation of property rights; e.g., whether or not the fence will be built, and, also, whether wealth of the two contending parties when taken together will be maximized. Let us return to our previous numerical example. First, assume that the judge again finds in favor of the rancher. Again, the fence will not be built. Coase welcomes this situation, since it would be wealth reducing to spend \$100 to save \$40. Second, posit that the judge rules in behalf of the farmer. Here, the fence will be built. The farmer has the right to insist upon this; if it is built, he stands to gain \$40 in the form of his corn not being eaten by the wandering cows. The cattleman cannot overcome the farmer's decision¹⁶ since the costs of paying the grower that \$75 to get him to cease and desist with his now legal demand for the fence, is much higher than any of the relevant costs or benefits.¹⁷ From Coase's point of view, where wealth maximization is the be-all and the end-all, this is an unfortunate judicial result, since, forgetting for the moment considerations of who has to pay what, \$100 will be spent in order to save \$40. So, what is Coase's advice to the judge, given this numerical example? It is to make the property rights award to the rancher, not the farmer. In that way, \$60 can be earned by society as a whole, in this case consisting solely of the two disputants. If this is done, \$100 will no longer be wasted in an effort to save \$40.

There are problems with this; numerous difficulties, all of them very serious. Let us list some of them.

First, note, this is a forward looking analysis, not a backward viewing one. Initially, at the outset, this even sounds like a positive attribute. After all, forward looking sounds like "with it," or "cool," whereas backward seemingly depicts fossilized, or old fashioned. But this perspective of Coase's is by no means to be welcomed on that ground. What Coase is saying is that a judge, sworn to uphold the law, will award property rights not on the basis of what has happened in the past, but what will (or, more accurately, is likely, or, better yet, what the judge thinks is probable) occur in the future. That is, he awards the property rights, in our case, to the rancher, because to build the fence will in the future cost more than the savings to be made, also in the future. The past simply drops out of the picture, except perhaps insofar as it can shed light on likely future phenomena.

¹⁵ However, Coase ignores the issue of psychic benefits; if the disputant who is supposed to make the bribe -- the farmer, here -- has no funds, and his benefits from the corn are psychic, not financial, then this scenario falls apart. I regard this as a very minor difficulty of the Coasean system. Demsetz and I have argued on several occasions (Block, 1977, 1995, 2000; Demsetz, 1979, 1997) whether this is indeed a flaw in Coase's analysis, or a misunderstanding of it on my part, so I will leave off this discussion at this point. For more on this debate see Block, 2010B, 2010C

¹⁶ which from his point of view is a reasonable one

¹⁷ Under some assumptions, these transactions costs are infinitely high

But to do this is to turn law upside down. The murderer is guilty not for what he may or might do in the future, but for what he has already done in the past.¹⁸ In like manner we condemn the rapist, robber, car-jacker, kidnapper not for any possible future actions of theirs, but for the criminal ones that have *already* taken place. This applies not only to criminal law, but to that covering torts as well. A sues B for damages A claims that B inflicted upon him in the past. The only time the future comes into play is when the plaintiff alleges that the defendant poses a threat to him. But if this does not occur, no damages or injunction would ever be awarded. It would be an utter denial of justice in any ordinary case to find a defendant guilty for what he might do in the future. This is apart, of course, from Coaseanism, upon which much of the entire law and economics field is predicated.

Second, the word "justice" appears nowhere in Coase (1960). Rather, the emphasis rests entirely on wealth maximization. Ordinarily, it may be stated, the two concepts tend to run in the same direction. Economic freedom is highly, and causally, connected with growth, wealth, prosperity, etc. (Gwartney, et al, 1976). However, it is more than passing curious that the concept of justice is nowhere considered in Coase (1960) which I interpret, insofar as law is concerned, as advice for the judiciary. But is it not the function of our courts of law to dispense justice? Do not plaintiffs and defendants each seek precisely that characteristic? An aggrieved party in a lawsuit may well complain of the unfairness of a decision, and we can empathize with him if we agree with him on this ground. But when someone before the bar is unhappy that the wealth of the society has not been maximized by a judicial decision, we can only gaze at him with slack-jawed wonder. That is not at all the purpose of a court, we might well be tempted to reply. The point here is that Coasean law is so far removed from real, ordinary, law, that it appears more lawless than lawful.¹⁹

Third, this system of laws is vulnerable to an entire series of *reductio ad absurdum*. For example, there is the utility monster who has been brought to bear to (intellectually) slay utilitarianism. Suppose there were a person who so enjoyed dining on human flesh that the utility he derives from cannibalism greatly outweighs the fear and revulsion that ordinary folk have at the prospect of being so treated. This monster comes to court claiming a right to eat an innocent victim. His argument is a Coasean one: he will gain 100 utils from his dinner, while his food, the other person, will only lose 40 utils thereby. In a zero transactions cost world, our cannibal, he claims, would be able to outbid the object of his culinary desires, given this state of affairs. Unfortunately for wealth maximization purposes, we live in the real world of very high transactions costs. So he appeals to the Coasean judge to award him the property rights in the other person. The jurist, if he is to stick to his Coasean principles, would have no choice but to uphold plaintiff's cause.

¹⁸ There is a fictional exception. Here is the description of the movie *Minority Report* (<http://www.imdb.com/title/tt0181689/>): "In a future where a special police unit is able to arrest murderers before they commit their crimes, an officer from that unit is himself accused of a future murder." But this premise must strike all sensible people as truly grotesque. Yet, this strikes to the root of Coase (1960) in that in both judicial findings turn on not what has already happened but on the basis of what the future will bring. Perhaps a Coasean was the script writer for this work of fiction.

¹⁹ It undermines the "rule of law." See on this Hayek (1973). For a critique of this concept, see Rothbard (1998, p. 183); Baumgarth, 1978.

Fourth, Coase's theory turns every judge²⁰ into a central planner. The numbers given above were for illustration purposes only; and this is Coase's practice in his celebrated article as well. And yet this author writes as if this information was a given to the jurists. Coase (1960) does not question this. But what comparative advantage do members of the bench have in assessing real world costs? None, would appear to be the appropriate answer. If we have learned anything from the study of socialism and central planning,²¹ it is that these modes of organizing economic activity are seriously wanting. And yet that is precisely what Coase makes of the judge: a central planner. But this is no more likely to succeed than centrally planned agriculture, centrally planned manufacturing, centrally planned marketing, or centrally planned anything else. There is simply no warrant for converting those with ermine collars into central planners. As Coase himself concedes, in the real world of high transactions costs, the judge's decision is crucial for the allocation of resources.

Fifth, and this will come as a complete shock to all Coaseans, relative prices change. No, I go further; they are continually altering. They vary with the weather, with population, with the prices of complements and substitutes, with income, with tastes, with innovation, etc. But if relative prices change, and relative prices are the basis upon which Coasean decisions are made, then these findings will have to be altered whenever this occurs. Since this takes place virtually continuously, verdicts will have to do so as well. If this does not put economic volatility through the roof and engender regime uncertainty as the order of the day, then nothing will.

Let us make this point in terms of the illustrative costs and benefits we have employed above. When the fences costs \$100 and the harm to corn is \$40, then it follows logically in the Coasean system that the rancher would have ended up not building the fence in the zero transactions cost world, and therefore would not be asked to do so by Coase in the real world of high transactions costs. But let us reverse matter s and posit that the fence requires an outlay of only \$40, and this will save \$100 worth of corn. Then, the Coasean judge will give the nod to the farmer. You say this cannot happen? Then you are maintaining that relative prices do not and cannot change. But they do, they do. Therefore, hyper volatility, here we come. Yet, this is never factored in to the Coasean analysis of wealth maximization. So even on that self-proclaimed ground itself the Coasean system is invalid. How can an economy prosper, let alone grow, if property rights can change from one second to the next? This kaleidic state of affairs must necessarily and continuously occur if titles to property are in thrall to the latest numbers on a stock or mercantile exchange. When the cost of fences relative to corn is at one ratio, property rights go to one contender; with another ratio, then to the other. This is a recipe for disaster, not economic growth. At least the communists had a relatively stable set of property rights: everything to the proletariat, nothing to the bourgeoisie. That is not very good, but at least it implies a stable definition of property. Coase's theory, if taken to its logical conclusion,²² does not even meet this low bar. "Instability" is its middle name. If there is any one thing that virtually all economists in general agree to, and in particular those involved in growth theory, it is the importance of private property rights (Bauer, 1981, 1984, 1991). Coaseanism knocks these out for a loop. With the rug pulled out from under private property rights, as would occur were

²⁰ At least those who think along Coasean lines

²¹ See on this Mises, 1922; see also Block, 2010A

²² And how else are we to take it if we are to do justice to it?

this theory, horrors!, incorporated into actual law, this would spell the death knell for prosperity, growth, any rational allocation of property rights.

III. The lighthouse

Coase (1974B) is unable to distinguish between a voluntary payment for service, and a compulsory levy enforced by government, e.g., a tax. According to Coase (1974B, 212): “The role of government was limited to the establishment and enforcement of property rights in the lighthouse.”²³ However, our author is caught with his pants down around his ankles when he also cites this authority on the matter: “Their Lordships cannot admit that is any violation of the principle of property in the reduction of a *tax* levied for public purposes, where no vested interests have been acquired in the proceeds of the *tax*; and where the tax in question is one levied upon a particular class of Your Majesty’s subjects, without that class deriving any adequate advantage in return (and any excess of light *dues* beyond the amount necessary to maintain the lights is a *tax* of this character), the reduction of such a *tax* not only involves no violation of the principle of property, but is in the highest degree just and expedient (emphases added).”²⁴ Now, which is it? Coase cannot possibly have it both ways.²⁵ If it is a voluntary payment, then it simply cannot be a tax. And, if it is a tax, then it cannot be a voluntary payment. And, if it is not a voluntary payment, then it cannot possibly be true that “The role of government was limited to the establishment and enforcement of property rights in the lighthouse.” Logic will not permit Coase to have his cake and eat it too. Here we have a blatant logical contradiction. It comes about, we hypothesize, because this author is simply unable to draw a distinction that is the most basic in all of political economy; that between free markets and statist coercion.²⁶

IV. Conclusion

The most important distinction in all of political economy is that between voluntary actions which are part of the free enterprise²⁷ system predicated on private property rights, and coercive ones, which are not. Coase’s grasp of this difference is non-existent. We have demonstrated this on the basis of two of his very famous articles, the ones published in 1960 and 1974B. In the first case, he sees no property rights violation when cows stray onto other people’s property. For him, the concept of “trespass,” and thus its polar opposite, “property rights,” are invalid. It is all, rather, a matter of wealth maximization. In the case of the lighthouse, Coase fails to see a difference between a voluntary payment made for services rendered, and a levy

²³ For support of this erroneous Coase position on the lighthouse, see Barrowclough (1999), Cowen (1988), Peacock (1979) and Spulber (2002).

²⁴ This is from the Report from the Select Committee on Lighthouses, in Parliament Papers, Session 1845, Vol. 9 at vi, as cited in Coase (1974B, 206).

²⁵ Well, perhaps, dispensations may be made to professors at the University of Chicago, particularly if they have won the Nobel Prize in economics, of which a disproportionate number have indeed.

²⁶ For other critiques of Coase’s view of the lighthouse along these lines, see Barnett and Block, 2007, 2009; Block, 2011.

²⁷ For a listing of scholarly work casting aspersions on Coase’s mantle as a supporter of free enterprise, private property rights and economic freedom see Barnett and Block, 2007, 2009; Block 1977, 1995, 1996, 2000, 2003, 2006, 2010A, 2010B, 2010C, 2011; Block, Barnett and Callahan, 2005; Cordato, 1989, 1992a, 1992b, 1997, 1998, 2000; Fox, 2007; Hoppe, 2004; Krause, 1999; Krecke, 1996; Lewin, 1982; North, 1990, 1992, 2002; Rothbard, 1982, 1997; Stringham, 2001; Stringham and White, 2004; Terrell, 1999.

compelled by government, which really amounts to a tax. This is pretty pathetic for someone as highly regarded as Coase as a leader in the field of political economy.

Let us end by considering a possible objection to the foregoing, particularly regarding my charges involving justice and wealth maximization. Coase does not take justice into account, certainly not explicitly. Nor do most economists. Utilitarianism is rampant in economics (Hodgson, 2013). So it would appear that I am blaming Coase for a flaw that is much more widespread. Indeed, for one that affects the entire profession of economics.

I plead innocent to this charge. My claim is that I am entirely justified in singling out Coase for blame in this regard. Why? Because Coase is smuggling in normative values into his supposedly value-free economics. Not that he is the only economist who does that. But his “sin” is more egregious than that of most. First of all, he is more famous and accomplished than virtually all others in our profession. Second, he is giving advice to judges as to how they should make legal determinations. He urges the bench to make awards in the real world of high transactions costs, to the party, either plaintiff or defendant, who would have ended up with the property right in question in the hypothetical, imaginary world of zero transactions costs.

But this is entirely illegitimate. There are no economists who can properly involve themselves in matters of fairness or justice. They logically *cannot* to any such thing.²⁸ For, economics is properly a value free subject.²⁹ It consists, solely, of positive statements about the economy. When economists delve into issues of justice, e.g., engage in *normative* economics, they are no longer doing so as strictly value free economists. They are now outside of the realm of economics, strictly speaking.

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²⁸ Smith (1759) of course is a seeming exception. But he does so not as a positive economist, but rather as an explicitly normative one. Even the very title of that book makes this pellucidly clear.

²⁹ States Rothbard (1976): "Economics as a *wertfrei* science. Praxeology, as deduction from self-evident axioms, makes no value judgments. These must be supplied by the economist when he advises on public policy: in doing so, he is not neutral." See also Block, 1975; Mises, 1949; Rothbard, 1957

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