Review of Austrian Economics, 13: 193–208 (2000)


# Chasing Phantoms in a Hollow Defense of Coase

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**Abstract.** Patrick Gunning refuses to acknowledge the most salient arguments against the "Chicago" law and economics case for negligence made by Austrian economists. Because of this, he makes the same errors in his defense of Coase that permeate the Chicago paradigm. In particular, his defense of Coasean type analysis completely ignores Austrian cost theory, i.e., that all economically relevant costs are strictly subjective and therefore conceptually impossible to measure. He also fails to grasp the implications of disequilibrium market process theory for the use of any kind of least-cost-avoider rule in the economic analysis of the law. As a result, Gunning's defense of Coase suffers from the same "pretense of knowledge" as the analysis that he is defending.

**JEL classification:** O24, O25, 916.

> "Referring to Coase's farmer-rancher case [where transactions costs are low], he [Cordato] suggests that even if property titles are clearly defined so that the farmer has full rights to the products of his effort on the land, the Coasean judge might consider awarding the right of use to the rancher, whose cattle strayed onto the land . . . Coase would not recommend that judges be given the power to transfer the right from the owner to a non-owner." (Gunning: pg. 184)
> "First, [in the farmer-rancher case] it still can be concluded, in the absence of insurmountable transaction costs, that a mutually satisfactory outcome will be obtained . . . *Left intact*, *then*, *is Coase's observation that in a zero or negligible transactions costs world*, *no outside intervention would be needed to resolve disputes concerning conflicts in the use of resources*, *so long as the right to bargain is guaranteed*." (Cordato 1992a:96) (emphasis added)

Unfortunately, upon reading Professor Gunning's article, I find that misrepresentations and mischaracterizations of my arguments, such as that cited above, are common throughout.[1] Indeed, I will argue that Gunning in large part ascribes to my discussion of Coase arguments that I didn't make, which he then goes on to show are wrong, and goals that I didn't have, which he goes on to show that I don't accomplish. Gunning also refuses to acknowledge important arguments that I do make against the "Chicago" law and economics case for negligence—the primary target of my discussion—and in this refusal, makes the same errors in his defense of Coase that permeate the Chicago paradigm. In particular, his defense of Coasean type analysis completely ignores Austrian cost theory, i.e., that all economically relevant costs are strictly subjective and therefore not simply difficult to measure, but conceptually impossible to measure. In doing so, the impossibility of making interpersonal utility comparisons is also completely ignored. As a further implication,

Gunning's defense of Coase suffers from the same "pretense of knowledge" as the analysis that he is defending.

## I. Gunning's Fundamental Misrepresentation

First, it should be made clear that my purpose for Chapter 5, the chapter that is the primary focus of Gunning's paper, was not to present a criticism of Coase's entire body of work on social cost, property rights, or even Coase's 1960 article, per se. As stated in the first sentence of this chapter, my target was "the economics of tort law, as it has developed in the Coasean tradition" (1992a:91). Furthermore, as I clearly stated, my point was to present "a critical assessment of both the Coasean foundations of law and economics and its applications, as developed by Posner, Polinski, Priest, and others. . . " (p. 91). As such, my book devotes only two pages (1992a:92–93) to Coase's 1960 article and has as its target, not Coase per se, but a paradigm launched by this article. What I go on to claim is that modern law and economics scholars, Posner et al., clearly see themselves as applying principles first set forth in this article, vis a vis the "least cost avoider rule" and the Hand formula.[2] In other words, my interpretation of Coase is the received interpretation as typically laid out by self-proclaimed Coaseans.

To make my case, on this point, I juxtapose language from Coase's 1960 article regarding the nature of the normative issue surrounding externality problems with statements from Richard Posner's text on law and economics to show that they are formulating problems of unintentional harms in identical ways (1992a:94). Again, this is not my argument, nearly all law and economics texts (Posner, Polinski, Coolen and Ulen) cite Coase's 1960 article as the foundation for their analysis. While I spend considerable time making these connections, Gunning does not even note that this is what I am doing.

Most of the quotes that Gunning uses from my book were written in this context. For example, on page 182 Gunning quotes a passage from my book that is written in the context of a criticism of the literature on the efficiency of the common law and the work of George Priest. Without acknowledging this context, Gunning claims, that I am commenting on Coase in quotes that he lifts from this section of my book, when in fact I am commenting on George Priest. He states that "Coase himself did not make the error that Cordato attributes to him" (p. 182). He then goes on to show that Coase, in works other than his 1960 article (which had no influence on this literature), was conscious of the point I made (in reference to Priest). The sentence immediately preceding the quote Gunning chose from my book states, "While Priest is describing a disequilibrium process, the focus is firmly fixed on the general equilibrium end state, which, implicitly, is part of the ceteris paribus conditions" (1992a:98). In context, it is clear that I am drawing out an implication of Priest's analysis and not attributing any position explicitly to Coase. I do claim, I think uncontroversially, that the efficiency of the common law literature is generally considered in the Coasean tradition of law and economics. An actual defense of the efficiency of the common law literature from Austrian criticisms would be valuable. Gunning neither makes this defense nor shows any knowledge of this area of law and economics.

I highlight all this because Gunning insists on characterizing my discussion in Chapter 5 as "a scathing criticism of Ronald Coase's paper on social cost" (p. 175) and implies that

it is an all-encompassing criticism of Coase on property rights, public policy or related issues. This allows him to bring into consideration articles by Coase that would have been irrelevant for me to cite. My attention to Coase's article was focused strictly on its role in providing the theoretical underpinnings of the greater literature on the economics of tort law. While this purpose is not at all obscure in my book, it goes completely unnoted by Gunning. Also, in this regard, I ascribe no policy conclusions to Coase, except for the favorable acknowledgment (characteristically misrepresented by Gunning) of the widely recognized policy conclusions of the Coase theorem quoted above. Indeed, I do not even claim that Coase supports a negligence rule in tort liability cases. While Coase's discussion suggests that he would, he does not get very specific on policy issues. Instead, I show how certain of Coase's statements and analysis in his 1960 article led to policy conclusions in the law and economics literature, in particular support for the Hand formula as a guide to judicial decision making. I refer to these policy conclusions as "Coasean" in the book not because they are advocated by Coase, but because they have been derived by their advocates by invoking, usually explicitly, Coase's theoretical perspective.[3] Again, I point this out because Gunning implies that I accuse Coase of being a "naive interventionist" (p. 190) and an advocate of "micro-management of economic affairs" (p. 175). A careful reading of my discussion does not support these claims. Although, I do believe that many "Coaseans" have taken his arguments in that direction. Indeed, it is Gunning who suggests policy conclusions for Coase that Coase does not explicitly advocate in his 1960 article, i.e., a negligence rule in nuisance cases and a distaste for a defense of coming to the nuisance.

Now Gunning may want to argue that these "Coaseans" have gotten Coase wrong, and of course he is free to do this. But I believe that a fairly straightforward line can be drawn from Coase's 1960 article to the policy prescriptions of these Coasean writers in the area of law and economics. As noted, it is a line that these writers consistently have drawn themselves and, to my knowledge Coase has not attempted to erase through disassociation. On the other hand, this is all somewhat besides the point because Gunning's arguments would suggest that he feels that Posner et al. have gotten Coase right.

## II. Subjective Value, Disequilibrium, and the Least Cost Avoider Standard

It might come as a surprise to someone reading Gunnings's paper, but who has not read either my book or my other articles on the same subject,[4] that at the center of my criticism of Coase's 1960 article and the policy conclusions that have flown from it, are issues related to the subjective nature of costs, the passage of time, and the information problems that these present. The overarching point is that the problems facing a judge attempting to implement a Coasean-type solution are similar to those that would face any central planner attempting to determine an "efficient" outcome for any market. There is no reason to think that it would be any easier for a judge implementing a least cost avoider rule to determine the efficient outcome in terms of the allocation of property rights in the market for railroad services and farmer's crops than in terms of prices and quantities, in the market for bread next year. The information requirements would be identical. In fact, if the crop is wheat, the Coasean judge would actually have to know the efficient outcome in the market for bread next year in order to come to his judgement. Indeed, this is a problem faced equally by the Coasen judge

in determining the efficient assignment of property rights and the Pigouvian tax assessor in determining the efficient externality tax (Cordato 1989).

### *A. It Matters That Costs Are Subjective*

Somehow Gunning manages to write a criticism of my arguments against Coasean analysis while scarcely mentioning my core arguments. First, interpersonal utility comparisons, and therefore an objective standard of value, are embedded in Coase's, and apparently Gunning's, definition of what constitutes an "efficient outcome." For Coase, the efficient outcome is one that maximizes the "social value of output." This is not only true in Coase's 1960 article but, apparently in his later writings. Gunning quotes Coase: "I conclude in 'The Problem of Social Cost' that the value of production would be maximized if rights were deemed to be possessed by those to whom they were most valuable, thus eliminating the need for transactions" (Gunning, p. 179). As Coase notes, this is exactly what he concludes in his 1960 article and it is the argument that guides Chicago school analysis in the area of tort liability.[5] From an Austrian perspective, this statement exemplifies the problem that is at the root of both Coase's analysis and its application in the law and economics literature.

What possible meaning could Coase's statement have in light of subjective value theory? If value stems completely from the intrapersonal rankings of ends on a strictly ordinal scale, then such a statement is conceptually vacuous. To whom is the value of production being maximized? Alternative arrangements of rights will increase the value of production to some and decrease the value of production to others. In terms of an economically meaningful, i.e., subjective, notion of value, that is all that can be said. It is also meaningless to talk about rights being "possessed by those to whom they were most valuable." Coase's statements imply a comparison of the preference rankings of different people and a "netting out" of utility gains and losses. It implies the making of interpersonal utility comparisons and therefore cardinal measurement. Please note, that I am not saying that it would be merely difficult to determine who would value the rights more, a point made by most who work in the law and economics paradigm, but that it is conceptually and scientifically meaningless to even speak in this kind of social cost-benefit terminology. No defense of Coase's welfare criterion can be made from an Austrian perspective without first dealing with this criticism. Gunning doesn't even acknowledge it. Indeed it is in his interest not to as his own analysis suffers from the same problem.

In Gunning's example, defending what is essentially a Posnerian type negligence rule (p. 184), a polluting factory is located in a populated valley. Without explicitly saying so he invokes the Hand formula in presenting two scenarios. "In the first case, we assume that the harm is very low relative to the factory's expense of preventing the gas from being emitted" and "in the second, we assume that the harm is very high relative to the factory's prevention expense" (Gunning, p. 184). He states in a footnote that harm and expense "include the opportunity cost of avoidance." These assumptions are void of economic content. It is not only that the analyst could never know that these assumption were true, which in and of itself would make the examples non-operational, but that the interpersonal cost comparisons are conceptually meaningless. These scenarios compare "harms" to one group of people, the residents, to "expenses" of another, the factory, "including the opportunity

costs of avoidance." Apparently he presumes, first, that it is methodologically sound to add up the opportunity costs to each of the residents in the valley to reach some sort of aggregate "measurement" of harm to the residents. And second he presumes that there is a meaningful way to compare this "measurement" to the "expenses" of the factory so that the comparison yields a scientifically valid conclusion in terms of social welfare. Like Coase's statement above, Gunning's assumptions imply cardinality and invoke interpersonal utility comparisons.

I remind Professor Gunning that subjective value theory implies that costs are strictly subjective and speculative. They represent the satisfaction that would have been obtained if choices that weren't made, were made. In light of this, to talk about interpersonal comparisons of the opportunity costs of avoidance, or any other kind, makes no sense. Yet Gunning's entire analysis, and therefore defense of negligence is based on these examples and the methodological appropriateness of making these kinds of comparisons. If these assumptions concerning comparative costs are vacuous then so is his defense.

It should be pointed out that these arguments have been part of the Austrian criticism of the Coasean law and economics paradigm for decades. Rothbard argued back in 1979 when discussing this same issue, that the entire concept of "social cost" is inconsistent with subjective value theory and is therefore a "myth." "If costs, like utilities, are subjective, non-additive, and non-comparable, then of course any concept of social costs, including transaction costs, becomes meaningless" (Rothbard 1979:92). And directly to the issue at hand, Rothbard argues that "if cost is individual, ephemeral, and purely subjective, then it follows that no policy conclusions, including conclusions about the law, can be derived from or even make use of [the concept of social cost]" (1979).[6] In spite of the fact that almost every Austrian who has analyzed Coasean-type analysis in law and economics has made these or similar arguments, Gunning makes no reference to this tradition in his paper.

One cannot overstate Gunning's negligence in not even addressing the issue of subjective costs in this context. Throughout the history of Austrian welfare economics and the Austrian criticism of standard welfare economics, there has been a fundamental concern with invoking interpersonal utility comparisons. It is this issue that motivated Rothbard to come up with his "demonstrated preference" theory of social utility (1977) and furthermore motivated a whole series of debates in the late 1970s and early 1980s on property rights related issues.[7] The fundamental Austrian argument against standard welfare economics—Pigouvian, Coasean, or otherwise—has been based on the grounds that these approaches invoke an objective theory of value. At no point in his discussion does Gunning defend Coase against this charge[8] and, furthermore, he goes on to commit the same offense himself throughout his own analysis.

### *B. The Importance of Assuming Competitive Equilibrium Prices*

Coase, when discussing concrete examples, such as the rancher and farmer or the farmer and railroad, realized, unlike Gunning (discussed below), the importance to his analysis of making the simplifying assumption that observed prices are "competitive prices." As Gunning points out, this allows Coase to talk about a zero transactions cost world,[9] but it also allows him to assume first that prices are precise measurements of marginal social costs

and marginal social benefits and second that there will be no change in the data over time.[10] To implement a Hand formula type solution in the real world, even if it were conceptually meaningful to make the interpersonal cost comparisons that it implies, one must assume that the underlying data doesn't change between the time that the necessarily historical cost calculations are made and the time that the judge and jury make their rulings. This process can sometimes take years. It would also have to be assumed that the data will not change in the future, unless one anticipates continuous litigation. In the laboratory examples presented by Coase, these problems are abstracted from by assuming a perfectly competitive world.

Unlike Coase, who recognizes the fact that these issues must be dealt with, at the very least by assuming them away with the assumption of competitive equilibrium, Gunning shows no such rigor in his examples. First, nowhere does he say that he is assuming competitive prices (so I will presume that he is not) and furthermore he claims that the judge would not have to figure them out. He states: "Nor is the idea that the judge would have to calculate general equilibrium values especially relevant here. He need only estimate the value of the right to the factory owner and the sum of the values to the residents" (p. 185). The fact that Gunning uses the word "only" and does not see the relevancy of general equilibrium values to the problem at hand, reveals a clear lack of understanding of the nature of the concept of value and the meaning of "social welfare" in the context of welfare economics. His use of the word "only" implies that this is not just a possible task, but a relatively easy one. But furthermore, if the calculations that were made were not based on general equilibrium prices, they would say nothing about social welfare.[11] They would not measure the opportunity costs or benefits to "society." As Rizzo pointed out in criticizing this approach to legal analysis, "Outside of general equilibrium, there is no objective measure of the social opportunity costs of resources" (1979:84).

The entire point, from Coase's perspective is to maximize the "social value" of output. Assuming that Gunning's factory owner and the valley residents are not the only people in the world, the judge's rulings would tell us nothing about Coase's fundamental welfare standard. Only a general equilibrium solution will ensure that Coase's welfare criterion is met. A partial equilibrium solution, which I assume Gunning is advocating, although he is not specific about this point, will leave open the possibility, if not the likelihood, that the reallocation of resources caused by the judge's order will be sub-optimal or Pareto inferior (from Coase's own perspective). Also, a partial, or non-general equilibrium solution would not take into account second best issues associated with monopoly and/or externality problems in other markets. Rizzo notes some of the information problems that would be faced by any judge attempting to implement an efficient legal rule while assuming only partial equilibrium. "It is necessary to know the degree of complementarity or substitution among goods, the value produced in each of the relevant sectors, the direction of the distortions elsewhere in the economy, and the sectors that aught to be viewed as constrained for the purpose of analysis" (1980b:652). In making his assumption about competitive prices Coase recognizes that these are issues that need to be abstracted from in order to proceed with his analysis. Gunning, on the other hand, does not even seem to recognize that they need to be addressed. This is intriguing given that these issues are so widely known among welfare economists and have been a standard part of the Austrian criticism of neoclassical welfare economics, both Coasean and non-Coasean.[12]

### III. The Faulty Concept of Rights to Control Actions

Professor Gunning introduces a concept that he calls "the right to control actions" as a vehicle for criticizing my exclusive focus on rights to physical property. First of all, this concept is at best nebulous as a distinct notion of rights that is separate from the right to physical property. Action always involves the use of some form of physical property, so that the right to control one's action is in reality a right to control physical property. In this sense, the right to control one's actions is not a distinct right. In the railroad/farmer example, the railroad's right to control his spark generating activities, this newly found factor of production, implies the right to control physical property, i.e., the trains, the train tracks, the land surrounding the tracks, **and**, in Gunning's example, the adjacent land that the farmer, not the railroad, happens to have title to.

This conflict between rights to physical property and rights to control actions is a false one. The right to control one's actions ultimately boils down to a right to control physical property. My attention to physical property rights recognizes the right to control one's actions within the context of this reality. People indeed have the right to control their actions to the extent that those actions are made in conjunction with physical property that is not someone else's. To claim that the right to control one's actions goes, or may go, beyond this boundary, as Gunning clearly does, creates the potential for the violation of the right of others to control their actions. It is a narrow focus on the right to physical property that ensures the right to control one's actions. If one were to adopt Gunning's position, where the railroad's right to control its actions may, depending on a judge's decision, include the right to use the farmer's crops as a receptacle for its sparks, the farmer's "right to control his actions" would be denied. Gunning's new right is self contradictory. The result of the farmer's actions is the production of his crops. The right to dispose of these crops as he sees fit would constitute a "right to control his actions," according to Gunning's definition. Enforcing the railroad's right to control its actions, if it includes a right to use the farmer's property, entails a denial of the farmer's right to control his actions.

From the perspective of externalties theory, Gunning's new right creates additional problems. From an efficiency perspective, catallactic or otherwise, an important purpose of property rights is to minimize externality problems. Gunning's new right, as he defines it, seems to create externality problems where there need not be any—giving rise to a necessity to choose between "rights" holders. Gunning's right to control action in the context of the railroad-farmer example entails, by definition, the use of the farmer's physical property by the railroad. Under a regime where rights to physical property are clearly defined and strictly enforced, interpersonal conflict is minimized. It is clear where the rights lie, and who has the right to use what. It is the introduction of Gunning's new found right to control one's actions, regardless of whose physical property those actions make use of, that gives rise to the externality problem and needlessly legitimizes interpersonal conflict.

There are a few particular points in Gunning's discussion of this issue that I would like to address. On page 178, Gunning misleads the reader by subtly transforming my arguments. He states: "The railroad previously had the right to operate his train near the farm. But the judge who follows the IIS rules [see appendix] is required to disregard this right. He should only pay attention to the rights to value embodied in the ownership of physical property, not in its use." This statement, consistent with Gunning's approach throughout, twists my

arguments to suit Gunning's needs. He first claims that the judge is required to disregard the railroad's right to operate "near" the farm. This is false. Indeed, I would argue that the judge in every respect should enforce the railroad's right to operate on all land owned by the railroad. By assumption, since the railroad's land is adjacent to the farmer's land, this is as "near" to the farm as one can possibly get. What the IIS judge would be required to do is to deny the railroad the right to operate **on** the farm. This is an important distinction that goes to the heart of the argument made in the previous paragraph. He then goes on to say that the IIS judge should only pay attention to "rights to value embodied in the ownership of physical property, not its use." This statement is also false. Nowhere do I claim that people should have a right to the value of anything, particularly as opposed to having rights to its use. Indeed it is the Coaseans who associate value and rights, as discussed at length above. The right to use property is at the center of what I argue courts should enforce. On page 66 of my book, citing and quoting Kirzner (1963) [see appendix], I state "[p]roperty rights should take the form of allowing the individual 'to employ the means available to him for the purpose of furthering his own ends'."[13] Elaborating on this, I state that "it emphasizes that people need to be allowed to **use** their property, both directly and through market exchange, in a way that is consistent with their own purposes" (1992a:67) (emphasis added). In light of these statements, it is difficult to understand what Gunning can be referring to in characterizing my arguments in the way that he does.

There is one point in this section of Gunning's paper that I agree with and would like to emphasize. On page 178 he states, "it [ ] is evident that following IIS rules would reduce the railroader's pursuit of her goals through the exchange process." This is true, in the same way that a good lock on my door reduces a potential thief's pursuit of her goals, through the exchange process and otherwise. Her goals vis a vis the exchange process, to fence my stereo after breaking into my house and stealing it, will be foiled. On the other hand, my goal to listen to my CDs in peace will be furthered. The railroader's goal to exchange its railroad services while using the farmer's property as a factor of her production will be thwarted while the farmer's goal to harvest and sell his crops in peace will be advanced. It is the nature of property rights enforcement to hinder the goal seeking activities of those who would violate those rights in the pursuit of their goals. Drawing the connection to externalities theory, any policy meant to limit the generation of negative externalities will indeed limit the goal seeking activities of the generators of the externalities while enhancing the goal seeking activities of the victim. Strict definition and enforcement of property rights is a way of resolving these disputes both a priori and ex post.

The fact that the sparks ended up setting the crops on fire because of an unanticipated drought, after a period of no drought and no damage (the premiss of Gunning's example) is irrelevant to this discussion. All this means is that the railroader received a windfall. She was able to use the farmer's land as a receptacle for her sparks for some period of time, while exposing the farmer to the risk that his crops could go up-in-flames anytime the conditions were right, without having to compensate the farmer for its use. Gunning's new found "right" of the railroader to "control her actions," proving the adage that no good deed goes unpunished, would have the effect of penalizing the farmer for being a generous neighbor.[14]

## IV. Coming to the Nuisance and the Issue of Uncertainty

In the last section of his paper, Gunning makes a great deal of my discussion of coming to the nuisance. In fact, from reading Gunning one would think that my entire case for a rule of strict property rights enforcement in tort centers around these two pages relating to coming to the nuisance. First, the purpose of this section was very narrow. It was to suggest a way that efficiency analysis might be used in dealing with situations where there is a conflict over the use of a resource that has no clear title holder. As a general proposition, I concluded that determining initial property titles is a task that is beyond economic analysis. I state that "since such decisions cannot be ends-independent, ethical arguments must come into play, and in many if not most cases, such decisions must be based on ethical considerations" (1992a:103). I conclude that "While economics may be able to shed some light on specific aspects of these issues, I believe that a complete solution to problems in these areas will require a non-efficiency-based theory of justice" (1992a:105). I point this out to give the reader the full context of my very narrow discussion of "coming to the nuisance."

My actual discussion focuses on a particular situation, stating that "catallactic efficiency can offer some guidance for certain kinds of nuisance problems in tort law" (1992a:103). This is a situation where there is a conflict over the use of a resource where there is no clear owner. As Gunning noted, I used the example of a factory dumping waste into a river that is simultaneously being used for recreational purposes downstream. By assumption, the river in this case is owned by neither party, nor anyone else. What needs to be made clear, in light of Gunning's discussion is that this is not a generalized endorsement or efficiency case for allowing the use of "coming to the nuisance" as a defense in tort cases. In fact, in a recent article (Cordato 1998) I specifically argue, agreeing with Epstein (1979), against such a rule on the grounds that it is inconsistent with strict liability and catallactic efficiency.

Once again, Gunning mischaracterizes the argument in my book, clearly suggesting that it is both a general argument for coming to the nuisance and that it is integral to the case for strict liability. Gunning, by jumping to these conclusions, which are not mine, puts himself in a strange position. He ends up arguing against a generalized use of coming to the nuisance as a defense in tort cases, a position that I am agnostic on in my book but agree with in my subsequent work. This puts him at odds with the most prominent work done on this issue in the Coasean law and economics literature, an article which Gunning mentions in passing by Wittman (1980). Wittman, unlike myself, and apparently Gunning, comes down, in favor of using a defense of coming to the nuisance, at least as an option that should be left open in most tort cases. He does this on what are clearly the same Coasean-based efficiency grounds that guide the Chicago law and economics literature generally and are apparently endorsed by Gunning. Gunning seems unaware of this tension within his own argument, indeed he seems unaware of the literature on this issue in general, except for his misrepresentation of my argument. As an aside, I should point out that my position is also at odds with some other Austrians on this issue (see Rothbard, 1982).

To deal with Gunning's discussion directly, it is important to note that he does not use the same example that I do in discussing coming to the nuisance. This is significant, because his example does not fit the type case where I believe coming to the nuisance would be acceptable. In other words, in the valley residents vs. factory case that he presents, I would

agree with him, all-be-it, for different reasons, that a defense of coming to the nuisance would not advance catallactic efficiency. As an aside, it should be pointed out that Wittman would probably argue in favor of at least considering such a defense in Gunning's case, strictly on Coasean efficiency grounds. As noted, my discussion applies only to situations where there is a conflict over the use of a resource to which there are no clear property titles. Gunning's example is not such a case. While it is true that no one has clear title to the air shed in the valley, this is not where the conflict lies. The conflict is over property that is clearly owned by the residents. In other words, the problem, I assume, is not that the pollution is being spewed into the air, but that it is landing on property owned by the residents—their lungs, their skin, their houses, their cars, etc.[15] A rule of coming to the nuisance would simply not be applicable since the relevant property titles are not in dispute. Ownership of the air is not relevant. Air is only the vehicle through which the effluence travels before landing on the resident's property. To say that this is a dispute over the use of unowned air would be equivalent to making the same claim about a shooting where the bullet first travels through unowned air before striking its victim.[16]

Furthermore, in making his arguments here, his case against strict liability, as with his case for negligence, is infused with interpersonal costs comparisons and therefore interpersonal utility comparisons. Let me reiterate, from a strictly subjectivist perspective, to the extent that any argument turns on the use of such comparisons, that argument is vacuous. Implied in his entire discussion on pages 187, particularly in situations where "the perpetrator cannot predict the size of the expected external cost," is the argument that, if a rule of strict liability were invoked the costs to the factory would outweigh the benefits to the residents. He even incorporates, wholly illegitimately, a cost-benefit calculous in discussing this issue from what he claims is a perspective of "catallactic efficiency." On page 188 he states, "From the standpoint of catallactic efficiency, all of these additional costs to the factory owner reduce the factory owner's opportunities to participate in the trial-and-error exchange process. However, they are offset by increased opportunities [benefits] on the part of valley residents . . . "[17] This superimposes his own cost benefit notion of efficiency on top of my theory of catallactic efficiency. It is methodologically incongruent to do this. If catallactic efficiency could be discussed in such terms, then, true enough, there would be no reason to criticize the Coasean approach. Indeed there would be much less of a difference between Austrian and non-Austrian economics and possibly no reason for an alternative view of efficiency.

It seems impossible at any point in his discussion of strict liability vs. negligence for Gunning to break free of an objective notion of costs and benefits. This is because the economic definition of negligence is based on an objective notion of costs and to defend it requires one to invoke such a notion. The standard law and economics definition of negligence, which Gunning at no point suggests is different than his own, is defined completely in terms of interpersonal comparisons of utility, i.e., costs. To quote Posner, "The defendant is guilty of negligence if the loss caused by the accident . . . exceeds the burden of the precaution that the defendant might have taken to avert . . . If a larger cost could have been avoided [to the plaintiff] by incurring a smaller cost [by the defendant ], efficiency requires that the smaller cost be incurred"[18] (Posner 1973:69).

Finally, in this section, Gunning suggests that my case for strict liability turns on the fact that it promotes certainty with regards to rights. First, as in several other instances, he fails to note that my arguments regarding certainty, are based on previous writings in the

Austrian tradition which allows him to ignore the greater Austrian literature on the issue. Contrary to his statement in footnote 11 where he claims that I "assert that not to enforce initial entitlements in property . . . would 'introduce a great deal of uncertainty with respect to property rights themselves,'" this is not an assertion at all. In this case I recount and cite arguments made by Rizzo (1980b). In this article Rizzo makes a case for strict liability based on issues of certainty and uncertainty. Without reiterating his arguments here, let me quote Rizzo's conclusions in hopes that the reader will review for himself Rizzo's foundational article on this issue.

"[T]he importance of certainty in the legal order is clear. Strict liability obviates or minimizes the need for courts to grapple, if only implicitly, with such impossible elusive problems as foreseeability, cheaper-cost avoider, social cost, and second best . . . [H]aving adopted the simple static framework of strict liability, we should find that there is considerably greater certainty about the locus of responsibility in accidents. This greater certainty promotes efficiency in the institutional sense because property rights, in effect, become more clearly or more definitely defined" (1980a:317). Gunning shows no evidence that he is aware of this discussion, in spite of the fact that Rizzo's article is cited as my source.[19] To ignore Rizzo's article in any discussion of this issue from an Austrian perspective is itself negligent.

The key point that I would like to make is that, while certainty in property rights is a central focus of Rizzo's case for strict liability, it is not the central argument that I make. The problem is that Gunning completely entangles my very narrow support for coming to the nuisance with my generalized case for strict liability. The only time the issue of certainty of property right comes up in my discussion of strict liability and the economics of tort in general is in my discussion of coming to the nuisance. Here I argue that, in the narrow situation described above, coming to the nuisance will enhance certainty with regards to legal rights and obligations which will in turn generate a greater level of certainty in the individual planning process. At no point is it invoked as part of my core case for strict liability. This is not the impression conveyed by Gunning. In my book, certainty as to rights and therefore the planning process, is invoked as *one* of the efficiency properties that I attribute to the IIS, but even here it is tangential and not essential. Indeed, the issue is not raised until the chapter after I make the basic efficiency case for the IIS. On the other hand, I do concur with Rizzo that an important property of strict liability, as opposed to a least cost avoider negligence rule, is that it indeed will promote certainty with respect to the future use of property and therefore minimize errors in the plan formulation process. So, even though I did not directly endorse Rizzo's conclusion in the section of my book on strict liability, let me do so here.

## V. Some Odds and Ends

To ferret out all of the inaccuracies and misrepresentations in Gunning's piece would require a line by line cleansing of his article. But there are some points that he makes that I simply cannot let stand. On page 176, Gunning makes a great deal out of what he characterized as an exclusive focus on the efficient pursuit of plans, rather than the achievement of goals, in my theory of catallactic efficiency. He suggests that the actual achievement of goals is, from my perspective, irrelevant. This is false. Indeed my entire discussion of catallactic

efficiency is based on the importance of people being able to choose means that are most likely to lead to the achievement of their goals. Gunning "proves" his point by selectively quoting phrases where I do not happen to specifically refer to goal achievement. In my book, I start my discussion of catallactic efficiency by invoking Kirzner's concept of efficiency for the individual (Kirzner 1963:34, Cordato 1992a:61) and ultimately conclude that the institutional setting for the market must promote this. I restate Kirzner's efficiency problem facing the individual actor as follows: "The efficiency problem in this setting is one of *achieving the desired goal* or set of goals by the most consistent use of means possible. For the individual, efficiency depends on the extent to which his actions, the means employed, are consistent with the goals or ends that are hoped to be accomplished" (1992a:61, emphasis added). I then go on to quote Kirzner as representative of my own views: "Efficiency for a social system means the efficiency with which it permits its individual members to *achieve their several goals*" (1963:35 as quoted in Cordato 1992a:62, emphasis added). Somehow, Gunning is able to read all this and conclude that in my analysis the actual achievement of goals are unimportant. It should be pointed out that even Gunning cannot keep up this deception for long. On page 178, in describing why I would be in favor of a judge upholding the farmer's right to use his land in peace, i.e., free from railroad sparks, he states, "Such a judgement would, in Cordato's view facilitate the achievement of individual goals through the exchange process." An issue that, p. 176, he suggested I care nothing about.

Also, in this same section, he discusses what I call the "ideal institutional setting" for achieving catallactic efficiency, the IIS (see Appendix). As I noted above, I adopt this framework from Kirzner (1963) and argue that it is identical to the legal framework implied by Rothbard's writing on welfare economics (1977). This institutional setting is fundamental to my argument for strict liability and is also central to much of Gunning's discussion. One would think that he would state these criterion exactly, either by quoting Kirzner directly, or my breakdown of Kirzner (where I quote him). Instead, he decides to convey his interpretation of the IIS in his own words. First, Gunning cites only two of the three criteria of the IIS, leaving out criteria number three. This is disturbing in that criteria number three is the basis for my advocacy of strict liability in tort. Strict liability is the logical implication of a legal setting where people's rights to use their property in pursuit of (toward the achievement of) their goals are to be strictly enforced. By ignoring criteria number three, Gunning abstracts himself from the peculiar position of having to argue that such rights shouldn't be enforced, even though this is an implication of many of his subsequent arguments. In criticizing my argument for strict liability it is incumbent upon Gunning to make explicit his disagreement with the principle of property rights enforcement entailed in criteria number three. If certain recognized titles to property should not be enforced, in response to a tort or any other kind of cross boundary invasion of property, then he should explain precisely on what margins such non-enforcements should occur and he should make explicit a non-cost/benefit based efficiency standard that justifies his position.

In addition to leaving one of the criteria out entirely (he states that there are only two), he is deceptive in his description of one of the two he does "recognize" (See the second criteria in appendix, see also footnote 13). This leaves the reader, for all intents and purposes, completely uninformed about the IIS and allows Gunning to criticize me, based on his misrepresentation. Again, I would like to suggest that if Gunning disagrees with

the specifics of criteria number two, suggesting that in the course of plan formulation and execution, individuals should be denied, at some margins, the right to make exclusive use of their property, then he should make this disagreement explicit. Again, he should provide an efficiency justification for his conclusions that is consistent with subjective cost theory.

## Conclusion

Gunning's defense of Coase or the Coasean approach, however his arguments are interpreted, have little to do with either the central theme of my arguments against Coasean analysis in law and economics, nor those that have been traditionally presented in the Austrian literature. Indeed Gunning shows very little if any familiarity with any of the Austrian discussions in this area. In order to refute the Austrian case against Coasean analysis, one would have to pursue several lines of reasoning. First he would have to demonstrate that either it is methodologically legitimate to invoke interpersonal cost-benefit comparisons and that the concept of "costs" to society is meaningful, **or** that Coasean analysis, i.e., the least cost avoider rule, despite what seems to be obvious to the contrary, somehow avoids such comparisons. Second it would have to be shown that such analysis, even if subjective value problems could be overcome, could be made meaningful in a disequilibrium world. In other words, in a world where the "efficient" solution is both unknowable and in a constant state of flux. Needless to say, Gunning does nothing to address these arguments. As such, his defense of Coase, as a defense from Austrian criticisms, is hollow.

Finally, I would like to encourage the reader to go to my book and read each of Gunning's quotes in context, and to verify that all of his representations of my arguments are accurate, before coming to any conclusions. This should be done for Gunning's initial volley, to which this is a response, and for his subsequent arguments, to which I will not have an opportunity to respond. This is an admonition that I have never had to make before, but, unfortunately, I find necessary to make here. I would also encourage the readers to review Kirzner's 1963 book and Rothbard's and Rizzo's articles cited here. All of this literature is important in understanding my discussions of both the Coasean approach to law and economics and the concept of efficiency in general.

## Appendix

The ideal institutional setting (IIS), as quoted from page 66 (Cordato 1992a), is meant to describe an institutional setting that would generate market activity that would be as efficient as possible. It is presented as an implication of the theory of catallactic efficiency.

"1. Individuals should have rights to property, i.e., title to property should be held privately.
2. Property rights should take the form of allowing the individual 'to employ the means available to him for the purpose of furthering his own ends' (Kirzner 1963:13).
3. In pursuing his own ends, the individual is obliged 'not [to] invade the property rights of others' (Kirzner 1963:13)."

The IIS is adopted from Kirzner (1963). Here he describes an "ideal system [that] may be thought of as . . . ensuring the smooth fulfillment of such cooperative arrangements" (p. 13), i.e., contract and exchange. The network of such arrangements is what Buchanan (1979), Hayek, and others have referred to as a catallaxy. Hence, the efficiency of this network is best described as "catallactic efficiency." Kirzner describes his "ideal system" as "[operating] within a framework of law which recognizes individual rights to property. This means that each individual is free at each moment to employ the means available to him for the purpose of furthering his own ends, providing only that this should not invade the property rights of others" (Kirzner 1963:13). From the perspective taken in my book, this institutional setting, through exchange, "will best facilitate the . . . discovery of information" and "will allow individuals to gather the necessary physical resources," both to be used for the formulation and execution of individually made plans (Cordato 1992a:63).

## Notes

1. Not only do I not claim that a Coasean Judge would rearrange rights in such a case, where zero transactions costs are assumed, it would be illogical to do so. In a zero transactions cost setting, there would be no Coasean judge. The case would never make it to court because no one would bring a claim. This is simply a tautology. A law suit is proof-positive that transactions costs are greater than zero.
2. The Hand formula, a formalization of the least cost avoider rule, was first made explicit by Judge Learned Hand in United States v. Carroll Towing Co., 159F. 2d 169 (2d Cir.1947). It holds that a defendant should be found negligent if $PL > B$, where $P$ is the probability that a loss will occur, $L$ is the value associated with the loss, and $B$ is the burden or cost associated with preventing the loss.
3. See the introductory chapters of almost any textbook in law and economics.
4. See Cordato (1989, 1992b).
5. In 1960, Coase declared "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 stopping the action which produces the harm" (1960:27). This is the "problem" of social cost that the title of Coase's article refers to.
6. For similar arguments regarding "social cost" and the law, see also Rizzo (1979).
7. Although no articles on subjective cost theory were referenced by Gunning (in a defense social cost from Austrian criticisms), the literature on this subject is extensive. A very short list includes Buchanan (1969), Pasour (1978), and Vaughn (1980).
8. I am clearly not the first to recognize Coase's lack of attention to subjective cost theory in his later writings. Pasour (1991 [1978]), after discussing Coase's early contributions to the London School's tradition in subjective value theory (Coase, 1981 [1938]), states: "Although the subjective nature of cost emerges clearly in his early work, Coase does not appear to have pursued the implications of this work as it relates to empirical applications of neoclassical price theory" (p. 286).
9. Gunning's explanation does not tell us why Coase assumes competitive prices in the railroad and farmer, positive transaction cost example.
10. There is an internal contradiction in making this assumption, both on the part of Coase and those who use his analysis in assessing issues in tort. As Rizzo points out "we must be outside [a world of competitive general equilibrium] in order to have any of the problems that the law of torts itself is designed to remedy. The coexistence of non-pecuniary externalities and general competitive equilibrium is impossible" (Rizzo 1979:78). Furthermore, the logic of simultaneously assuming perfectly competitive prices and positive transactions costs itself is contradictory (see also footnote 1).
11. This point is widely recognized even by Cooseans. In an e-mail discussion (AustrianEcon@agoric.com, November 10, 1996) I asked David Friedman the following: "what kind of conclusions [regarding social efficiency] could be reached, [given the Coase Theorem example of cattle straying onto a farmer's land, destroying crops] if we assume that bargaining is taking place based on prices that are not inequilibrium?" His answer was "None you can't reach any efficiency conclusions about anything if you assume not only

that you are out of equilibrium but that you know nothing at all about the relationship between prices and equilibrium prices."

12. As Rizzo notes, "Of what value is partial efficiency when one of the major purposes of legal rules is to take account of third party effects? If incorporating spillover effects in complementary and substitution markets decreases net value, it is small comfort indeed to know that value was maximized as between the two litigants" (1980b:653). On the importance of assuming general equilibrium prices, the reader should also see Rothbard (1979).
13. This is directly quoting, in its entirety, the second characteristic of the IIS (see appendix). On page 176 Gunning, when discussing the IIS, misstates this proposition, claiming that "the second is freedom to exchange." This obviously allows him, at this later juncture, to ignore the actual point which is to ensure the more general freedom to use. Typically for Gunning, instead of directly quoting exactly what the three characteristics of the IIS are, which I did not derive myself but adopted, with credit, from Kirzner (1963) (a point also not noted by Gunning), he missummarizes them and then uses the false summary as a basis for criticism later on. Kirzner uses the same institutional setting, which he refers to as "ideal," as the institutional basis for his coordination standard of efficiency (1963).
14. Remarkably, Gunning's conclusion in this case comes very close to an endorsement of a first use rule, a position he rejects later in his discussion.
15. In Wittman's article he deals with a very similar, if not completely analogous case, where a pig farmer is emitting odors that are a nuisance to it neighbors. In this case, as with Gunning's example, I argue against a defense of coming to the nuisance (1998).
16. This is a point I have made relating to environmental policy and tradeable emissions permits (Cordato 1997), see also McGee and Block (1994).
17. I would like to refer the reader to my previous discussion about how all property rights enforcement foils the plans and exchange opportunities of property right violators. Also, the analysis that Gunning pursues here is the result of his original, misleading summarization of the IIS as supporting an open ended right to make exchanges (see footnote 12). It is yet another example of how Gunning will misstate an argument of mine and then go on to use the misstatement as a basis for further criticism.
18. A comparison between this quote and the quote from Coase at note 5 should dispel any doubt that the modern law and economics view of negligence is a direct application of Coase's welfare standard.
19. Indeed, strict liability itself has been advocated by Austrians as an approach to issues in tort for as long as Austrians have been discussing such issues (see Rizzo (1980a, 1980b), Rothbard (1982), and Lewin (1982)) and is clearly an implication of both Kirzner's coordination standard of efficiency (as noted above Kirzner introduced what he called the "ideal system," and what I call the "ideal institutional setting," in his 1963 book) and Rothbard's demonstrated preference standard. Again, Gunning shows no recognition or knowledge of this lineage in spite of the fact that all of this literature is cited in my book.

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