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Property Rights and Externality: The Ethics of the Austrian School*

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Introduction

Economists who are impressed with the efficiency of a free market in many areas of human interaction are often stymied when attempting to achieve those same free-market efficiencies in cases of externality. Resolving certain problems of externality seems to be impossible without resorting to some degree of government intervention. It is difficult in many situations to imagine a satisfactory property rights-based solution to externalities. Arguably, the most difficult case of externality for the free market to solve independent of government intervention is that of air pollution. This is because there potentially exist many dispersed producers of the pollutants and many dispersed victims of the pollution. Voluntary contracting among the many individuals and firms is virtually impossible because of extremely high transaction costs.

Those economists identifying themselves as Austrians have persisted, however, in maintaining that free-market solutions do exist for air pollution and other externalities. Rejecting the Coasean view that varying allocations of property rights in externality cases have no effect on the outcome as long as transaction costs are zero, Austrians hold that a strict-liability, tort-law approach based on fundamental axioms of private property will resolve externality conflicts appropriately. Many Austrians tend to reject notions of "social efficiency," claiming that conflicts must be addressed using an ethical system based on deductive reasoning from these "self-evident" axioms.

The Austrian critique of Coase is powerful, and a thoughtful Christian may well find substantial agreement with this and many other contributions of the Austrian School. However, at the most basic level, the Austrian School lacks a firm ethical foundation.[1] After outlining key points of the Austrian view of

externality resolution as expressed in Murray N. Rothbard's paper "Law, Property Rights, and Air Pollution,"[2] I will argue that the underlying assumptions of some libertarians regarding externalities should be better defended if they are to support an entire "system of property rights titles." Ultimately, an ethical approach to property rights and environmental externalities must depend on biblical truth.

Rothbardian Solutions to Externalities

Austrian Economics Versus the Coase Theorem

Ronald Coase[3] and Harold Demsetz[4] began with the assertion that the victim of an externality is equally responsible for the damage done him. Writes Coase, "[it] is not that the man who harbors rabbits is solely responsible [for damage done to neighboring fields]; the man whose crops are eaten is equally responsible."[5] The idea of "fault" disappears in the Coasean world, as the distinctions between perpetrator and victim are blurred. Courts would attempt to award property rights in such a way as to maximize social wealth, though much "wealth" is invisible to the courts, as will be shown later.

A classic example used to illustrate the Coase Theorem is the case of a railroad track running alongside fields of grain. The steam locomotive emits sparks from its stack, some of which land in the field, setting the grain on fire. It is true that without the presence of both the field of grain and the locomotive, the damage would not occur. The question before the judge is: Should the locomotive be permitted to continue emitting sparks, or should the farmer receive rights to continue to grow grain undamaged by sparks? In a zero-transactions cost setting, says Coase, resources will be allocated identically no matter which party receives the rights to enjoin the other.

If the farmer receives the right to have spark-free fields, the railroad will take costly measures to (i) prevent damage from occurring, or (ii) compensate the farmer for damage that does occur, or (iii) do some mixture of both prevention and compensation.[6] If the railroad receives the right to continue emitting sparks, the farmer will approach the railroad with an offer to pay the railroad to take the same actions.

For example, if the farmer is losing $20,000 per harvest to fire damage, and the property rights are assigned to the farmer, the railroad will have to compensate the farmer $20,000 or take other costly measures, whichever is cheaper. If the property rights are assigned to the railroad, the farmer will pay up to $20,000 to the railroad to eliminate the damage. If abating the damage is more expensive than the value of the grain, no abatement will occur, regardless of the

allocation of property rights. Alternatively, if abating the damage is less expensive than the value of the grain, abatement will occur regardless of the allocation of property rights.

The court does have an impact on the wealth of the disputants, of course. If the farmer receives the rights, the railroad will lose up to $20,000 per harvest. If the railroad receives the rights, the farmer will lose the same amount per harvest. Here we can see the source of one Austrian objection to the Coase Theorem. Wealth does have significance to both of the involved parties, and it does make a difference to them (though, perhaps, not to the smoke abatement equipment manufacturer) as to which one receives the property rights.

To understand the main Austrian objection to Ronald Coase's famous theorem, we must recall the distinctive Austrian concept of subjective value. Walter Block writes, "as long as the values of both sides in the legal dispute were real, or general, … Coase's Theorem was correct. However, if these values were psychic or not general across at least a few people, it was incorrect."[7] If the farmer has any inalienable value in his field of grain—if his field has value for him that cannot be traded away—the farmer may not be able to pay the railroad to abate spark emissions. Further, the farmer will not be willing to accept the market value of the grain in compensation, for the market value of the grain is less than the total value of the grain to the farmer. Even in a zero-transactions cost world, it matters which party receives the property rights. As Block notes,

> there is no guarantee that the loser will have the requisite funds with which to bribe the victor, even if he indeed values the bundle of rights under contention to a degree greater than his opponent. Coase had supposed that the payment could be financed out of the greater value; but if this took the form of mere psychic income, it would be unable to do any such thing.[8]

Under a court's application of the Coase Theorem, then, great losses of subjective value produced by aggressive acts may not be fully recovered by the victim. The result can be a violation of basic economic or religious freedoms.

Demsetz advocates coercive reordering of property rights to a resource based on a court's determination of the most profitable use of the resource.[9] Because subjective values and religious beliefs cannot be easily assessed by judges, their manipulation of property rights could easily result in the loss of freedom to practice true religion. In what Block notes is a "highly emotional example," Demsetz puts forward the case of a resource owned entirely by a religious sect, which preserves the resource exclusively for religious worship. The resource, dubbed "Austrian Pure Snow Trees," happens to be the only cure for cancer, but the sect fervently believes that using the trees for curing disease would be

a sacrilege resulting in certain eternal damnation. On the implicit assumption that the religious sect is wrong in its views, Demsetz argues that it would be preferable for a redistribution of property rights to occur. Block interprets Demsetz such that Demsetz "must claim that the law should be written so as to attain this result…."[10]

Twin Axioms: Self-Ownership and Homesteading

Instead of the efficiency-based, "value-free"[11] approach of Coase and Demsetz, Rothbard proposes a normative approach based on two related axioms, defended by Austrians as "self-evident."[12] The first of these is that "every man is a self-owner, having absolute jurisdiction over his own body." The second axiom follows from the first: "Each person justly owns whatever previously unowned resources he appropriates or 'mixes his labor with.'" From these two axioms stems the libertarian "harm principle": "No action should be considered illicit or illegal unless it invades, aggresses against, the person or just property of another. Only invasive actions should be declared illegal, and combatted with the full powers of the law." Tort law, Rothbard believes, can form the foundation of a libertarian society. Only a physical invasion of person or property constitutes a tort, and physical force may be used to defend against or punish those torts.

The second axiom mentioned above is also known as the "homesteading principle." A consistent application of this principle establishes the right to transfer property through sale, gift, or bequest. Rothbard, attempting to resolve modern externality problems, applies the homesteading principle to air pollution and noise pollution issues. Easement rights to pollution are acquired, he says, by "prior claim" to emit certain levels of pollution:

> It should be clear that the same theory should apply to air pollution. If A is causing pollution of B's air, and this can be proven beyond a reasonable doubt, then this is aggression and it should be enjoined and damages paid in accordance with strict liability, *unless* A had been there first and had already been polluting the air before B's property was developed. For example, if a factory owned by A polluted originally unused property, up to a certain amount of pollutant X, then A can be said to have *homesteaded a pollution easement* of a certain degree and type.[13]

The homestead principle allows for varying conditions in different areas and over time. The case of *Bove* v. *Donner-Hanna Coke Co.* (1932) is illustrative. Mrs. Bove had moved into a factory district, across the street from Donner-Hanna Coke Company. When Mrs. Bove took the company to court, complaining of noise and air pollution, the court wrote:

> With all the dirt, smoke and gas which necessarily come from factory chimneys, trains and boats, and with full knowledge that this region was especially adapted for industrial rather than residential purposes, and that factories would increase in the future, plaintiff selected this locality as the site of her future home. She voluntarily moved into this district, fully aware of the fact that the atmosphere would constantly be contaminated by dirt, gas, and foul odors; and that she could not hope to find in this locality the pure air of a strictly residential zone. She evidently saw certain advantages of living in this congested center. This is not the case of an industry, with its attendant noise and dirt, invading a quiet, residential district. This is just the opposite. Here a residence is built in an area naturally adapted for industrial purposes and already dedicated to that use. Plaintiff can hardly be heard to complain at this late date that her peace and comfort have been disturbed by a situation which existed, to some extent at least, at the very time she bought her property.[14]

Torts of trespass or nuisance, Rothbard makes clear, only exist insofar as they harm the homesteader. Thus radio waves, while they cross geographical property boundaries, may be legally broadcast without violating anyone's property rights because property owners are not harmed by their transmission (if they were proven to be harmful beyond a reasonable doubt, the broadcast should be enjoined, Rothbard notes). The radio station owner has homesteaded the electromagnetic spectrum for those frequencies and distances over which he broadcasts, and, therefore, he has property rights in that spectrum.

Likewise, those who seek to reduce air pollution in their neighborhood do not have a case if either (1) the polluters of the air were producing at their present level of pollution before anyone else moved into the affected area, or (2) the pollution cannot be linked beyond a reasonable doubt to harm suffered by the complainants.

Criteria for an Ethical Legal System

Austrians derive from the basic harm principle several other criteria for an ethical legal system. One is that the burden of proof in a tort case should rest upon the plaintiff. This may be intuitively appealing, but Rothbard's defense of the principle is weak—he relies exclusively upon the raw assertion that "if we are unsure [of the guilt or innocence of the defendant], it is far better to let an aggressive act slip through than to impose coercion and therefore to commit aggression ourselves."

Another criterion is strict causality. "To establish guilt and liability," Rothbard writes, "strict causality of aggression leading to harm must meet the rigid test of proof beyond a reasonable doubt."[15] Again, it is not clear how Rothbard derives this principle from the two basic axioms.

Following from strict liability is the doctrine that only the aggressor should be liable for torts against the victim. Nonaggressors may not be lumped in with the aggressor for expediency or for any other reason. This principle would seem to follow directly from the harm principle as well as from strict liability.

Rothbard on Externalities

Rothbard summarizes the libertarian position on externalities as follows:

> Anyone who initiates [an overt act of aggression against the person or property of someone else] must be strictly liable for damages against the victim, even if the action is "reasonable" or accidental. Finally, such aggression may take the form of pollution of someone else's air, including his own effective airspace, injury against his person, or a nuisance interfering with his possession or use of his land.
>
> This is the case, *provided that:* (a) the polluter has not previously established a homestead easement; (b) while visible pollutants or noxious odors are per se aggression, in the case of invisible and insensible pollutants the plaintiff must prove actual harm; (c) the burden of proof of such aggression rests upon the plaintiff; (d) the plaintiff must prove strict causality from the actions of the defendant to the victimization of the plaintiff; (e) the plaintiff must prove such causality and aggression beyond a reasonable doubt; and (f) there is no vicarious liability, but only liability for those who actually commit the deed.[16]

Rothbard collapses all crime into tort law, so that no one other than the victim can press charges against an aggressor—not the state nor any other entity. Giving some attention to problems of multiple aggressors and large numbers of victims, Rothbard asserts that victims may not join others to the suit as plaintiffs without their permission, as class action suits do.

Weaknesses in Libertarian Property Rights Theory

For all of the strengths of Rothbard's arguments and the power of the Austrian critique of the Coase Theorem, there remain some weaknesses in the foundations of libertarian property rights theory. I shall direct my criticism at the level of the two basic axioms upon which Rothbard builds his entire political theory:

> The basic axiom of libertarian political theory holds that every man is a self-owner, having absolute jurisdiction over his own body. In effect, this means that no one else may justly invade, or aggress against, another's person. It follows then that each person justly owns whatever previously unowned resources he appropriates or "mixes his labor with." From these twin axioms—self-ownership and "homesteading"—stem the justification for the entire system of property rights titles in a free-market society.[17]

Though these axioms are interrelated, I shall address them independently.

"Every Man Is a Self-Owner"

The first axiom is not intuitively obvious. It is a statement that, by its very nature as an "axiom," cannot be defended empirically and must therefore be accepted on faith. Questions of faith certainly bear on economics, but without an internally consistent, trustworthy, revelatory document, these questions cannot be answered definitively. Rothbard does not present or even argue the existence of such a document. The entire system derived from the faith-based assertion is therefore on shaky ground. Those who do not share Rothbard's faith will not necessarily accept this first axiom.

The self-ownership axiom has a defense based on Hans-Hermann Hoppe's argumentation ethic. Hoppe writes that the process of argumentation necessarily presupposes the existence of private property:

> Argumentation … is a form of action requiring the employment of scarce means; and furthermore that the means, then, which a person demonstrates as preferring by engaging in propositional exchanges, are those of private property. For one thing, obviously, no one could possibly propose anything, and no one could become convinced of any proposition by argumentative means, if a person's right to make exclusive use of his physical body were not already presupposed.[18]

In other words, it is self-contradictory to oppose private property verbally without contradicting oneself. Because one must assert private property rights in one's own body in order to make any argument whatsoever; one cannot make any consistent argument against private property. N. Stephan Kinsella explains quite clearly Hoppe's point:

> Anyone engaging in argumentation implicitly presupposes the right of self-ownership of other participants in the argument, for otherwise the other would not be able to consider freely and accept or reject the proposed argument. Only as long as there is at least an implicit recognition of each individual's property right in his or her own body can true argumentation take place. When this right is not recognized, the activity is no longer argumentation, but threat, mere naked aggression, or plain physical fighting. Thus, anyone who denies that rights exist contradicts himself since, by his very engaging in cooperative and conflict-free activity of argumentation, he necessarily recognizes the right of his listener to be free to listen, think, and decide. That is, any participant in discourse presupposes the non-aggression axiom….[19]

This sort of reasoning is quite appealing, and many in the Austrian tradition

have adopted Hoppe's reasoning as their ultimate defense of private property (which is to say, their ultimate defense of the whole libertarian system).[20]

This defense of the self-ownership axiom relies upon the rule of ethics that an ethical system must apply equally to all people.[21] If this rule did not hold true, a special entity or class of entities could own one or more people. No reason why this rule of ethics must hold true is presented—it is accepted on faith and is therefore subject to the criticism above. It is no defense to place the burden of proving the existence of owned people on the opposition, for Hoppe presents no compelling reason to believe that this universality rule should hold sway over any other ethical rule. The Christian may assert that God is the Creator, and therefore the owner, of all men. The Christian ethical system applies equally to all people in principle, but only because God has *chosen* to act in this way with his creation, not because God is *constrained* by an external rule of ethics. The universality rule is appealing, but it cannot stand apart from an ethical system that supports and applies it. The burden of proof can equally as well be placed upon Hoppe to show that the universality rule is superior. Furthermore, it is also no defense to defend the self-ownership axiom with the homesteading axiom,[22] for I shall show that the homesteading axiom has difficulties of its own.

"Each Person Justly Owns Whatever Previously Unowned Resources He Appropriates"

This axiom is alleged to follow from the first. Because each human must make use of substances outside his own body to survive, each human is entitled to appropriate all substances outside his own body with which he mixes his labor (to follow John Locke) and that are not owned by another. Writes Hoppe,

> It would be … impossible to sustain argumentation for any length of time and rely on the propositional force of one's arguments, if one were not allowed to appropriate next to one's body other scarce means through homesteading action, i.e., by putting them to use before somebody else does, and if such means, and the rights of exclusive control regarding them, were not defined in objective, physical terms. For if no one had the right to control anything at all except his own body, then we would all cease to exist and the problem of justifying norms—as well as all other human problems—simply would not exist. Thus, by virtue of the fact of being alive then, property rights to other things must be presupposed to be valid, too. No one who is alive could argue otherwise.[23]

This argument is a *non sequitur*. It does not follow that because I must use certain substances outside my body, that I must therefore appropriate them as

my own property. Not only is it possible not to own our own bodies, it is possible to use things that we do not own—even things necessary for our very survival. Again, if we can imagine the existence of an entity or class of entities that owns a person or group of persons, we can easily imagine that that entity also owns all substances necessary for that person's survival. For some reason, that entity may permit the use of the human body and substances surrounding that body. The Christian defends God's ownership of the world, and all that is in it.[24] Our bodies, and all we possess, may be thought of as being lent to us for our temporary use and enjoyment.

To return to our *non sequitur*, consider the life of a newborn baby. Newborns cannot appropriate to themselves any substance that is not given to them—not milk, not covering, not a crib.[25] Though we typically do not declare that a newborn is *owned* by his parents,[26] it is clear that the newborn depends for his very life upon substances owned by his parents. For their own reasons, parents permit and even encourage the use of these substances by the child.

It is not necessary that the owner of property of any sort *claim* rights to the property to *retain* rights to the property. The owner's quiescence does not deprive him of the right to his property. If a person is owned by another entity, he may never even know of the entity's existence. Certainly atheists do not admit to God's existence, much less to his ownership of the world. Yet their belief has no impact on the fact of God's existence and sovereignty over his creation.

Hoppe says that to argue presupposes private property rights. He does not say (nor would it seem that he can show) that failure to argue implies a lack of property rights. It is not clear, then, under Hoppe's argumentation ethic, why animals do not have property rights in their own bodies.[27]

Conclusion

The twin self-ownership and homesteading axioms are the foundation upon which all libertarian social thought supposedly rests, according to Rothbard and Hoppe. If they cannot be defended with anything more than raw assertions, then they deserve no more attention than most Austrian economists give to econometrics. Austrians do have devastating criticisms of Coasean and Pigouvian schemes of externality resolution. What is needed is a better way of defending an alternative scheme based on private property rights. Rothbard and Hoppe are correct in seeking fundamental ethical norms to support private property rights and liability rules, but they are short of their goal.

To support private property rights and draw nearer to a resolution of the problem of externality, we must begin to recognize God's ownership of creation. For the self-ownership and homesteading axioms, Christians should

substitute two axioms derived from the Bible: (1) God owns the creation, and (2) God provides a system of ethics that must govern our use of the creation. Ultimately, Christians who wish to make consistent contributions to the ethics of property rights and produce constructive contributions to externality theory must rely on biblical truth.

Notes

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1. Of course, many Austrians view Austrian economics as a body of analytical thought, not an ethical system, and believe that there is no "Austrian" ethical position. Austrians are deeply divided on their ethical views, and in many cases it is difficult to see any ethical views in their work. However, the prominent Austrian Murray Rothbard and certain of his followers (notably Hans-Hermann Hoppe) have espoused a particular ethical view in their attempts to defend private property rights. It is this view that is the focus of this paper.

2. Murray N. Rothbard, "Law, Property Rights, and Air Pollution," *Cato Journal* 2 (1989): 55–99.

3. Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960): 1–44.

4. Harold Demsetz, "Some Aspects of Property Rights," *Journal of Law and Economics* 9 (1966).

5. Coase, "The Problem of Social Cost," 37.

6. This may include the installation of a smoke abatement device, running fewer trains along the track, paying the farmer to leave that part of the field near the track unused, or compensating the farmer for damage actually done.

7. Walter Block, "Ethics, Efficiency, Coasian Property Rights, and Psychic Income: A Reply to Harold Demsetz," *Review of Austrian Economics* 8 (1995): 64.

8. Ibid., 65.

9. Harold Demsetz, "Ethics and Efficiency in Property Rights Systems," in *Time, Uncertainty, and Disequilibrium: Explorations of Austrian Themes*, ed. Mario Rizzo (Lexington, Mass.: D. C. Heath, 1979).

10. Block, "Ethics, Efficiency, and Coasian Property Rights," 78. For the Block-Demsetz debate, see Harold Demsetz, "Some Aspects of Property Rights"; "Toward a Theory of Property Rights," *American Economic Review* 57 (1967): 347–59; "Ethics and Efficiency in Property Rights Systems"; and "Block's Erroneous Interpretations," *Review of Austrian Economics* 10, 2 (1997): 101–9; Walter Block, "Coase and Demsetz on Private Property Rights," *Journal of Libertarian Studies* 1, 2 (1977): 111–15; and "Ethics, Efficiency, Coasian Property Rights, and Psychic Income: A Reply to Harold Demsetz."

11. The Coasean view is actually not value-free. For instance, as Rothbard points out, Coaseans do not defend their assumption that efficiency—an ethical norm—should prevail in establishing legal principles.

12. See David Gordon, *The Philosophical Origins of Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1993), 28–30.

13. Rothbard, "Law, Property Rights, and Air Pollution," 77.

14. Quoted in Rothbard, "Law, Property Rights, and Air Pollution," 79.

15. In a paragraph that has great relevance for current legal battles, Rothbard writes: "Thus, if lung cancer rates are higher among cigarette smokers than noncigarette smokers, this does not in itself establish proof of causation. The very fact that many smokers never get lung cancer and that many lung cancer sufferers have never smoked indicates that there are other complex variables at work. So that while the correlation is suggestive, it hardly suffices to establish medical or legal proof; *a fortiori* it can still less establish any sort of legal guilt (if, for example, a wife who develops lung cancer should sue a husband for smoking and therefore injuring her lungs)."

16. Rothbard, “Law, Property Rights, and Air Pollution,” 87.

17. Ibid., 60–61.

18. Hans-Hermann Hoppe, *The Economics and Ethics of Private Property* (Boston: Kluwer, 1993), 205.

19. N. Stephan Kinsella, “New Rationalist Directions in Libertarian Rights Theory,” *Journal of Libertarian Studies* 12 (1996): 315.

20. Even so, many Austrians (e.g., the Kirznerians, the Hayekians, and some Rothbardians) do not agree with Hoppe’s argument. See endnote 1, above.

21. This universality of ethical norms is, according to Hoppe, “the idea, as formulated in the Golden Rule of ethics or in the Kantian Categorical Imperative, that only those norms can be justified that can be formulated as general principles which without exception are true for everyone.” *The Economics and Ethics of Private Property*, 182. This definitional statement is apparently supposed to suffice for a defense of the universalization test of ethical rules.

22. Such a defense might run as follows: Because each human was the first to make physical use of his own body, each human has effectively homesteaded his own body and is therefore entitled to property rights in it.

23. Hoppe, *The Economics and Ethics of Private Property*, 205–6.

24. Psalm 24:1–2 states: “The earth is the Lord’s and all its fullness, The world and those who dwell therein. For he has founded it upon the seas, And established it upon the waters.”

25. We will allow that the child can appropriate air to himself.

26. This, however, would not be a difficult case to make under Hoppe’s system. The parents cooperated in “laboring” to produce the child, who did not exist before conception. If the parents have property rights over their own bodies and substances with which they mix their labor, it would appear that Hoppe cannot contest the ownership of the child by the parents. The Christian can counter with the argument that God, as owner of all living things, retains property rights over the offspring of his creation.

27. Hoppe vociferously contests the validity of this criticism (see pages 205 and 247) but his objections appear to be raw assertions: “Animals are not moral agents, because they are incapable of argumentation; and my theory of justice explicitly denies its applicability to animals and, in fact, implies that they have no rights!” The Christian argues for or against certain animal rights based on biblical truth, not the presence or absence of the ability to argue (see, e.g., Deut. 25:4, John 21:9–13). It would also appear that the killing of human fetuses, infants, the senile, mentally retarded, and the comatose would be acceptable under Hoppe’s ethical system because they cannot argue.