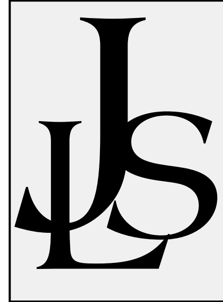
THE JOURNAL OF LIBERTARIAN STUDIES



AN INTERDISCIPLINARY QUARTERLY REVIEW

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IS "MALINVESTMENT" ENOUGH TO GO BUST?

ENRICO COLOMBATTO

THE BUSINESS CYCLE REFERS to fairly broad changes in economic activity according to a well-identified sequence, which includes a boom, a crisis, a period of stagnation, and then a new expansion.[1] This sequence tends to repeat itself; but neither the length of the cycle, nor the intervals between cycles necessarily follows a regular time pattern. There is substantial agreement both about this definition and about the temporal irregularities. The only open question is on whether the cycle should be described in terms of proportional changes in GDP, or rather in terms of GDP deviations from a long-run trend. Following the early literature on the subject, this paper accepts the first definition.

As regards the analysis of the origins and features of the cycle,[2] the Austrian theory posits that cycles are characterized by generalized inefficient economic behavior induced by active monetary policies.[3] That is, although the business cycle involves real variables, its

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[1]Despite its widespread use, stagnation may nevertheless be a misleading concept. Depression is probably a better way to describe the final period of the cycle. See also Rothbard (1969).

[2]See for instance Garrison (1989, 1991) on the main features of the various business-cycle theories.

[3]Previous attempts to analyze the trade cycle by emphasizing monetary issues are to be found in Juglar (1862); or in Tugan-Baranovsky (1901), who investigated mismatches between savings and investment plans. The Austrian approach, on the other hand, is based on the divergence between the natural and the market interest rates. Kirzner (2001, p. 138) suggests that the foundations of the Austrian theory of the business cycle are due to Wicksell and Böhm-Bawerk, and that Mises himself in some way acknowledged it. However, Mises brought the various pieces together, thereby putting forward for the first time a complete theory of the cycle based on the interaction between real and monetary phenomena.

dynamics are started and initially driven by monetary phenomena. Both at the start, when the market rate of interest falls below the "natural" rate of interest and a boom is ignited and later on, when fundamentals eventually prevail and trigger the crisis: mismatches come to the surface, panic breaks out in the money market and past mistakes have to be reckoned with.

The first part of this article is thus devoted to a short discussion of Mises's view on money. The central sections analyze how money management can influence economic behavior and upon which conditions the Austrian theses hold. The final sections will then address some issues in current policy making in the light of an "extended" Austrian theory of the business cycle.

MONEY PRINTING

In Mises's view the monetary environment can be manipulated through straightforward money printing and the creation of other fiduciary means of payment (credit).[4] The distinction between the two is important in two respects. First, there exist different consequences on inflation, which is here defined as a general increase in prices. By affecting the extent to which a monetary unit is a reliable standard, inflation plays a significant role within the Austrian theory of the business cycle. In addition, tampering with these two magnitudes—commodity money and credit money, following Mises's terminology (1996, p. 429)—may lead to diverse economic behaviors, and thus to outcomes of a different nature in terms of business-cycle analysis.

The Austrian approach maintains that the timing and features of the price increases induced by money printing depend on the identity of the money printer and on his goals. For instance, when money printing is carried out by a government agency (including the central

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[4]Following the Austrians, money is here considered as a means to carry out transactions, either immediately or later on in time; see Mises (1912; 1923; and 1996, pp. 428–34). When buying a commodity, the seller accepts monetary units as a form of payment because that unit represents purchasing power that can be taken advantage of, either shortly afterwards (cash as a better alternative to barter) or later (deferred payment). Thus, money is a means to carry out transactions if it is preserved and perceived as a reliable unit of purchasing power.

This is why ultimately a monetary regime is always a fiduciary system. The problem is of course swept under the carpet by imposing a legal tender, whereby the government forces individuals to accept a purchasing-power certificate.

bank),[5] one has to consider the direct and indirect beneficiaries of government expenditure. If extra cash is needed to raise wages in the public sector, the price and quantities of the various goods adjust according to the way civil servants will be spending their extra balances. Relative prices will thus undergo substantial variations, as some sectors are hit earlier than others, and some adjust more rapidly than others do. Indeed, it may take months, if not years, for a money-printing policy to develop its inflationary consequences completely. Hence, during and soon after money printing has taken place, money demand can actually rise in real terms to the extent that individuals do not spend the additional cash balances immediately and all the prices do not reach their new equilibrium levels.

Expectations matter, of course. But from an Austrian viewpoint it is unlikely that agents fully realize and correctly discount the inflationary features of money printing. Understanding all the consequences of the various types of government expenditure and assessing their quantitative impact is simply impossible. More realistically, individuals are deemed to extrapolate past trends for the prices of the goods and services they are interested in, and possibly adjust their estimates according to the perceived intentions of those operating the money-printing machines. These estimates may also be augmented so as to include some demand components—say—to discount that the demand for liquidity drops (expands) as perceived inflationary policies intensify (weaken). Such educated guesses are then applied to contracts concerning deferred payments.

All this contributes to explaining the difficulties in adjusting to and fighting inflation. Data assessment may also be blurred. For instance, an unexpected, once and for all money-printing policy leads to a temporary increase in the real demand for money and an improvement in nominal and deflated GDP, since the nominal increase in purchasing power is not matched by an equi-proportional increase in the price level. As time goes by, and as long as real output stays constant, demand for money eventually falls back to its initial level—or for some time even below, if money printing is expected to continue. Prices gradually rise and possibly overshoot their final

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[5] It is hardly worth pointing out that there is no such thing as an independent central bank. For whatever the goal of the central bank, its "monetary constitution" comes from some state power. That is also the reason why the governors of the central banks abstain from printing money whenever they need a little cash for their personal expenses. In fact a truly independent central bank should be able to print whatever amount is deemed appropriate and distribute it to whomever its governor or chairman likes—including himself, of course.

level, while deflated GDP statistics return to their initial values, after a possible and temporary drop below it (see appendix 1). From this viewpoint, what may be described as a cycle is in fact just a statistical illusion.

Of course, if inflation is low and prediction errors are modest, the monetary unit is considered reliable and accepted. The loss of purchasing power is tolerable and cash can be used for short-term transactions and for deferred payments, once the necessary adjustments are made.[6]

For the purpose of the present paper one can thus conclude that a monetary regime transmits real shocks through the system when the standard is bad, but not bad enough to be rejected. In particular, the standard is not rejected (1) when uncertainty about the real variables is perceived to be high, so that abandoning the current monetary standard is not thought to bring about large enough improvements; (2) when inflation is not acute; or (3) when money-printing does not take operators by surprise, so that adjustment remains feasible.[7]

To conclude, from the Austrian standpoint money printing *per se* does have some effects on statistics; but little or no impact on the real business cycle.[8] Surely, during the monetary cycle—the definition is

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[6]As a matter of fact, when paper money is used as a standard for deferred payments, both the buyer and the seller are never certain about the purchasing power of the monetary unit, even in the absence of inflation. Relative prices change all the time, as a result of technological progress; but also as a result of changes in preferences or of the appearance of new products.

[7]It may be worth pointing out that in Mises's view agents anticipate the inflationary effects of money printing (despite the fact that price increases hit industries at different times, which makes prediction impossible). And that when people become aware of the perverse effects of inflation, "undesired consequences" follow.

Such "undesired consequences" clearly apply when the system does not break down and a new standard fails to be introduced. Put differently, the unattractive features of a bad standard actually depend on what prevents the actors from switching to a better standard. The introduction of legal-tender legislation is of course a prime candidate in this respect. Hence, the real side of the Misesian economics of money-printing (as opposed to credit policy) actually raises a range of questions about the variables that prevent a bad standard from being abandoned and on the cost of abandoning it. This is why the Austrians are often tempted by free banking as a powerful institutional instrument to fight the business cycle. See for instance Mises (2002).

[8]However, Mises (1996, p. 573) rightly observes that if the new supply of money "reaches the loan market at an early stage of its inflow into the market system," then its effects are equal to those typical of credit expansion.

our own—purchasing power moves from some groups of individuals to other groups, so that important redistributive effects may take place. Repercussions on the structure of production are also to be observed, if the various groups display different tastes and different time preferences. The Austrians, however, do not believe that either phenomenon is likely to be substantial. More important, they do not accept that money-printing *per se* is going to affect the market rate of interest either, which therefore remains approximately equal to the natural rate of interest. The monetary cycle is then harmful since it pushes the relative-price structure away from relative scarcities. It may thus provoke losses of output and statistical illusions. But it does not necessarily ignite the real business cycle, unlike—say—in Friedman (1976), where inflationary phenomena induce workers to act irrationally.

ON THE ECONOMICS OF CIRCULATION CREDIT

The Monetary Side of the Austrian Cycle

In Böhm-Bawerk's (and Mises's) work, the business cycle differs from the monetary cycle because in the former case the real interest rate is altered by the banking sector when manipulating the nominal rate. This is the essence of the so-called "circulation credit theory," whereby banks supply "circulation credit" (in this case a synonym for fiduciary means of exchange), that is a means of payment accompanied by a promise to exchange them against goods or money at some future time, possibly on demand.[9] The Austrian School develops this theoretical insight in order to demonstrate that a sustained and credible departure of the real interest rate away from the Wicksellian natural rate sets the business cycle into motion. Indeed, the cycle consists of intertemporal mismatches in the fixed-capital industry provoked by forced changes in the interest rate.

Hence, as a referee of this journal notes, "more circulation credit or more money used first on the loan market drive the business cycle."

See also Garrison (1996) for a comparison between the Monetarist and Austrian approaches.

[9]Means of payment backed by monetary units (money) actually deposited by individuals are called "commodity credit." See Mises (1928, pp. 124 and 125). More generally, commodity credit concerns a transaction where "what is surrendered consists of money and goods, disposal over which is a source of satisfaction and renunciation of which a source of dissatisfaction" (Mises 1912, p. 297). This is opposed to circulation credit, where "the granter of credit renounces for the time being the ownership of a sum of money, but this renunciation . . . results for him in no reduction in satisfaction" (ibid.).

Banks are ready to lend at an interest rate below the natural one because when issuing fiduciary means of exchange no money deposits are required. Therefore, banks are in a condition of at least temporary seigniorage. Over the period during which nobody asks to replace fiduciary means with money, any interest paid by the borrower is then a net profit (once the costs of running the fiduciary system are deducted).

Understandably, banks seek to expand circulation credit in order to maximize interest payments; the greater the trustworthiness of the issuing bodies and the more they are able to carry out price discrimination *vis-à-vis* borrowers, the greater the profits. At the same time, banks tend to limit the amount of fiduciary means of exchange outstanding in order not to undermine the credibility of these means of payment and—more generally—of the unit of account in use. Since a fiduciary system can work as long as it is a promise of future backing, too large a quantity of fiduciary means of exchange makes the promise less credible.[10] This self-enforcing mechanism prevents fiduciary means from getting out of control as soon as they are introduced.

Now, given the overall picture presented above, it is clear that

- Banks gain considerably if nobody ever asks to change fiduciary means into goods or into real purchasing power: no "reverse seigniorage" occurs. Of course, this situation (full seigniorage) occurs only if the nominal demand for money increases and fiduciary means are perceived as substitute for money.
- Banks can still gain substantially (interest payments) if reverse seigniorage occurs after borrowers have had

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[10]An important exception to this is the case when a fiduciary means of exchange is no longer credible, but the State meets demand for money by printing it and banks know in advance. In this situation banks have a clear incentive to expand fiduciary means *ad infinitum*. This helps understand the origin of the pressures toward more regulation and supervision. A central bank that issues regulation in order to prevent unlimited expansion of fiduciary means is thus an authority that implicitly announces it will save the regulated bank in case of bankruptcy.

It is also worth pointing out that under such circumstances a strict monetary policy may be either a blessing or a disgrace. It favors the banks if it generates excess money demand and thus a higher propensity to accept fiduciary means instead of money. But it could also be a kiss of death if, as a consequence of such a policy, agents no longer trust fiduciary means and rush to ask for money instead.

sufficient time to expand production and create enough goods to pay interest *and* meet the purchasing-power promise embedded in circulation credit.

- The system crashes if nominal money demand stays put and reverse seigniorage occurs before borrowers (producers) have been able to create enough real backing for the fiduciary means of exchange issued in previous periods.
- Inflation breaks out if money demand does not rise much, output growth is sluggish and reverse seigniorage does not occur (fiduciary means are accepted as a perfect substitute for money and used to buy goods). Indeed, inflation is the mechanism through which aggregate money supply in real terms is brought back to its original level (i.e., before circulation credit was created).

Mises's position within this fairly general framework is straightforward. In his view the injection of circulation credit inevitably leads to inflation. Panic and eventually reverse seigniorage follow. Bad investment decisions undertaken under the influence of easy money are exposed, and the closing down of inefficient ventures generates recession. The size of adjustment depends on the amount of fiduciary means of exchange outstanding. Since the length of the boom is assumed to be directly correlated with the amount of circulation credit, the longer the boom, the more catastrophic the crisis.

The simplicity of Mises's approach appears plausible—and indeed appealing—if three fundamental assumptions of the early-Austrian tradition hold:

(1) Banks issue circulation credit because they rule out large-scale reverse seigniorage and/or they trust that a state agency will come to the rescue and back their empty promises;

(2) Investment plans are changed, whereby resources are rerouted toward relatively bad projects ("malinvestment")[11];

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[11]Malinvestment means that the lower market interest rate induces producers to move from investment projects with short-run returns to schemes profitable in the longer run. Thus, after the boom has been ignited consumer goods actually tend to become scarce, as resources are moved away from building factories soon ready to produce consumer goods, toward projects that are going to generate output only in the long run. This phenomenon is also known as "forced savings." It has however been admitted that overall production can actually rise even in the short run. See Haberler (1996, pp. 40–41) and, more generally, Garrison (2002).

(3) Producers borrow and keep borrowing because they are mistakenly persuaded that they will be able to complete their revised investment projects and service their debts.

Put differently, the early-Austrian view of the business cycle refers to a situation where production is not rising (it is actually falling, since malinvestment is likely to imply some switching costs). At some stage inflation becomes substantial, agents no longer consider fiduciary means of exchange equivalent to money and reverse seigniorage occurs. Under these circumstances banks are unable to meet their promise and collapse jointly with that part of the economy trapped in malinvestment. The depth of the crisis depends on the size of the monetary overhang, which is possibly aggravated by the fall in output as more and more resources had been moved from short-run to long-run-yield investment projects. Intervention by the central authority is of course possible. But even if the central bank steps in and prints money to be exchanged for fiduciary means of exchange, the monetary overhang remains unaltered and the crisis cannot be averted. Actually, inflation rises and the crash deepens.

The End of the Boom

Mises's descriptions of the boom and of the crisis are persuasive. Still, closer scrutiny reveals a number of issues that deserve clarification and suggest a partially different kind of analysis. In particular, the following paragraphs will concentrate on two periods—the end of the boom and depression.

As regards the former, it is indeed possible that fiduciary means of exchange lead to excess money supply and thus inflation. But for inflation to go off, fiduciary means must remain in circulation. Put differently, inflation occurs if agents accept fiduciary means, reverse seigniorage does not take place, and excess aggregate money supply leads to excess demand for goods. As long as fiduciary means of exchange remain in circulation the consequences are thus similar to those generated by money printing. It is as if the printing machines were located with the commercial banks rather than with a central bank. It follows that the consequences are rather limited and associated with the ability to predict the price rise and adjust accordingly (see the previous section). At the other extreme, if money and fiduciary means of exchange are not deemed equivalent, reverse seigniorage takes place right away, even before inflation becomes substantial.

Let us however follow Mises and take an intermediate case, whereby fiduciary means of exchange are initially accepted as a substitute for money, but after a while—as sequential inflation is still underway—is returned to the banks in exchange for money. At that moment the financial system is taken by surprise. Would banks ask

producers to reimburse their debts in money, as Mises seems to suggest? Probably not, since producers do not normally finance long-term projects with short-term credit, as mentioned above. That does not mean that they anticipate a crash or a depression. But it does mean that they perceive low interest rates as an exceptional opportunity, rather than as the rule. In short, when crisis breaks out producers will presumably be protected by their contracts, which are unlikely to include clauses allowing reimbursement on demand. At that moment producers will certainly revise their investment strategies, and new projects will be selected according to the new conditions—which include a higher interest rate. However, since malinvestment is financed at the depressed interest rates, when the injection of fiduciary credit comes to an end, producers do not suffer because they already received the financial resources they needed. In other words, nothing prevents them from enjoying the benefits of the low-cost financing acquired during the boom.[12] Banks only go bust. What happens next depends on the destiny of the bad (fiduciary) money. If it is accepted again as a substitute for money, then inflation keeps following its course, as mentioned earlier. In the opposite case the theory of the business cycle turns out to be the analysis of the redistributive effects taking place when allegedly good money is suddenly perceived as bad money and loses its role as purchasing power.

From this viewpoint the early-Austrian story then argues that the boom is over when reverse seigniorage eventually takes place or is at least attempted. Although this may be a plausible description of how the boom comes to an end, it all relies on the fact that at a given moment operators lack confidence and producers get squeezed. How and when this happens remains unclear. In fact the banking crisis will hit short-run operations to a larger extent than long-run projects: Contrary to the latter, the former usually involve financing that can be reneged upon at very short notice. Curiously enough, producers who engaged in malinvestment to a greater extent are going to be those less vulnerable to the crisis. Thus, unless borrowers had wrong expectations on interest rates, or consumers' preferences have changed, or technological progress has accelerated,[13] when the boom

[12]The next section will explain upon whose shoulders the cost of malinvestment is likely to fall.

[13]If consumers' preferences change during a boom, producers find out that they wasted money in the wrong industries, supplying products that nobody wants any more. Or that the boom generates exceptional technological progress, so that many early investors are induced to sink resources into technologies that are soon bound to be obsolete.

ends and the market interest rate goes back to its original level, producers have no reason to worry. Surely, they will not start additional malinvestment. But unless one introduces additional elements, it is hard to see why they need to close down factories or scrap capacity.

In short, the Misesian story without further qualifications does not really lead to depression, a period which indeed plays a relatively minor role in the analysis (Garrison 2002). Paradoxically, by taking the early-Austrian path one ultimately runs the risk of sliding toward Keynesian conclusions. That is, the boom is welcome whenever it offers a chance to expand production and the policy maker is relied upon in order to keep agents confident—for instance by offering a state guarantee to currency credit, as history shows.

On the Consequences of the Interest-Rate Gap with New Production Plans

In order to complete the analysis of the original Misesian version of the cycle a final element deserves attention. As observed earlier, at the beginning of the cycle circulation credit provides certain short-run profits and latent long-run losses (if the central bank declines to help and reverse seigniorage occurs).

When the market rate of interest falls below the natural rate, agents observe that the reward on postponed consumption has become lower. Hence, they react by increasing immediate consumption and by reducing savings. The rise in immediate consumption reflects a lower equilibrium natural interest rate, while the fall in savings reduces the funds available for commodity credit. As for investors, it is hard to believe that when credit becomes cheaper they drop their current investment projects and engage in reshuffling (malinvestment). Instead, it is more realistic to imagine that they

- accept fiduciary credit in order to expand or reschedule production capacity or
- choose to replace commodity credit with (cheaper) circulation credit, so that their investments (and their debt) remain roughly unchanged, but servicing is cheaper.[14]

If producers expand their production plans at the lower market interest rate, they are *de facto* accepting fiduciary means of exchange.

[14]The first hypothesis actually violates Mises's assumption about mere reshuffling, but is still compatible with the aggregate-output constraint. The second possibility is indeed consistent with Mises's version, but implies that by switching from commodity to currency credit investors change the structure of their investment for the worse (malinvestment) and scrap at least part of the projects already under way.

This behavior is actually encouraged when commodity credit becomes scarce as a consequence of lower savings.

If aggregate production cannot rise—say, because factor supply is rigid—higher demand for immediate consumption makes it worthwhile for producers to use easy credit to expand output of consumption goods. Put differently, fewer resources will be set aside to enhance future production (and therefore satisfy deferred consumption) and more will be employed to expand present output. Of course, they may also commit themselves to expanding production in the long run, as long as (1) they extrapolate recent trends in current demand and thus misread a movement along an intertemporal demand locus as an outward shift of demand; and (2) they believe that the resources required to start planned accumulation will be made available in the future. By doing so, they are in fact preparing the ground for future excess capacity.[15]

In this light, malinvestment does reflect a situation whereby investors change their plans: in particular, medium-term investment ventures are replaced by greater output of consumer goods and by new commitments for future accumulation, with an emphasis on long-term projects. Following Menger's terminology, one may say that production concentrates on low-order and high-order goods, while leaving a possible gap in the middle. True enough, the Austrians—e.g., Hayek (1931)—do acknowledge that demand for consumption goods may rise as a result of the rise in the wage rate; and that this may lead to an increase in the prices of such goods. But whereas the Austrians assume that during the boom the *relative* price of consumer goods falls,[16] we here claim that far more relevant is that producers perceive that the price of the first-order goods relative to primary inputs is increasing and creating profit opportunities.

The consequences of the interest-rate misalignment finally become apparent when consumers find out that accumulation has been falling below what would have been necessary to meet their expectations, i.e., that their consumption frontier is no longer what they had expected (see appendix 2). Put differently, when the interest

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[15]Under normal conditions the market would have signalled the problem, for low current savings would have led to a higher interest rate, thereby discouraging producers from undertaking long-term projects. But of course, during the boom propelled by circulation credit the signal is erroneous.

[16]Bellofiore (1999, pp. LIV and LXXV–LXXVII) refers to Wicksell and Hawtrey (1935), and aptly points out that such an assumption is crucial, but not explained. See also Donzelli (2003), according to whom changes in relative prices are crucial in Böhm-Bawerk's and Hayek's versions of the Austrian trade cycle, but neither in Wicksell nor in Mises's.

rate declines consumers reduce their savings for they believe that this entails a relatively small sacrifice in terms of future consumption (the interest rate has fallen). But since the marginal rate of transformation remains unaffected, the production possibility frontier is constant and future production necessarily drops by a relatively large amount in order to satisfy present consumption. One can thus conclude that the injection of fiduciary means of exchange has been feasible because consumers (not producers) have been deceived. They have been led to increase their immediate consumption by underestimating the opportunity cost of their decision. Their miscalculation has been provoked by their having perceived the lower interest rate as a signal for a free lunch being made available. Under such circumstances, crisis clearly breaks out when consumers realize that there is no free lunch. At that moment either inflation or—more likely—reverse seigniorage occurs.

Once again, if one accepts that producers respond when consumers are induced to expand current demand, the notion of "malinvestment" needs to be reassessed. It no longer describes producers moving from short-run to long-run projects, but rather from capital-goods industries to consumer-goods industries, while committing themselves to long-term investment projects by extrapolating current demand trends. Unfortunately, their investment decisions today will not match tomorrow's consumption requirements. Investors go wrong because consumers' behavior leads them to do so. When this becomes manifest, the crisis predicted by the early Austrians breaks out.

On the Consequences of the Interest-rate Gap with Constant Production Plans

The second prospect mentioned earlier refers to the possibility that investors have fixed investment plans and take advantage of circulation credit in order to reduce debt servicing. Since the rate of return on savings does not match the rate of time preference, demand for immediate consumption increases, similar to the previous case.[17] If such rise in demand for immediate consumption cannot be met in the short run, the price of consumption goods rises and the excess money supply disappears. As a result, the creation of fiduciary means of exchange leads to inflation and redistribution: Holders of cash balances lose as their purchasing power falls, while banks

[17]It is assumed that on aggregate producers remain net borrowers of fiduciary means. This explains why Mises focuses on producers as the primary "beneficiaries" of these newly-available funds.

and producers gain (due to seigniorage and cheaper debt servicing, respectively).

The new environment can of course stabilize if no further currency credit is issued and no reverse seigniorage takes place. After the shock produced by the creation of new (fiduciary) money and the destruction of the excess money supply by inflation have taken place, the market rate of interest goes back to the original rate.[18] On the other hand, if reverse seigniorage does take place, banks are asked to change fiduciary means of exchange into money. Then, the market rate of interest overshoots its initial level, as banks have to attract savings both to provide for commodity credit and to replace fiduciary means. Deflation sets in and the redistributive flows are reversed. Crisis can then break out if producers are not able to meet higher debt service, which is indeed the case under Mises's assumption of reshuffled investment plans.[19] Producers are impaired to the extent that they have been weakened by malinvestment and do not have the resources to endure the inverse redistributive flows.

Preliminary Conclusions

One can thus conclude that the early-Austrian business cycle starts from the plausible Wicksellian assumption whereby banks take advantage of at least temporary seigniorage and produce a real shock by generating an interest-rate gap. The gap leads to new behavioral modes by consumers as well as by investors, ultimately ending in crisis. In particular, the crash occurs when agents find out that their new consumption plans are not consistent with the intertemporal production frontier. Then, they revert to their original consumption patterns by increasing their savings, while fearing that fiduciary means of exchange may be reneged upon by the banking system.

However it is clear that the boom—whatever that means—need not end up in a real or financial crash. From the real standpoint it all depends on the features of the possible mismatch between the structure of demand and the structure of supply when agents revert to their previous consumption patterns. Furthermore, inflation actually avoids reverse seigniorage. For instance, if the central bank comes to the rescue and injects money, inflation comes to the surface, but the financial crisis may still be averted.

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[18]Note that this is more or less what happens within the monetary cycle. This is hardly surprising, since the creation of circulation credit has in fact been considered equivalent to money printing.

[19]The previous caveats on borrowing contracts apply, though.

The redistributive features depend on how the newly printed money is assigned. Following the explanation suggested in the previous paragraph, banks are in the greatest need for rescue. If money is pumped into bankers' pockets, income will be redistributed from all agents to bankers and debtors, following the economics of sequential inflation.

THE DYNAMICS OF THE BUSINESS CYCLE RECONSIDERED

A Different Version of the Austrian Boom

Finally, one is also left wondering about the actual meaning of a boom according to the early-Austrian vision. If the original Misesian approach is accepted (aggregate production remains constant), the boom is necessarily just a monetary phenomenon.[20] On the other hand, this puzzling terminological aspect disappears if a boom implies extended or constant production plans and a rise in current consumption (which runs against the traditional forced-savings theory, though).

A more realistic exploitation of the early-Austrian insights calls attention to other phenomena typical of a boom. One is the rise in current consumption that induces producers to transform accumulation into commitments for expanded future investment. The other is associated with the possibility of drawing new factors (labor, mining, land) into the production process. To the latter case we now devote our attention.

The main problem with the Misesian business cycle is that it is difficult to see how more resources are allocated to long-term projects,

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[20]Lower interest rates in a Misesian economy necessarily generate an increase in production (a boom) only if they lead to the employment of production factors that would have stayed idle in the evenly rotating economy. Mises (2002, p. 130) actually seems to perceive the question, but does not pursue the matter further. More generally, the first three Austrian generations perceived the boom as a period through which investment crowds out consumption (Böhm-Bawerk) or—even less plausibly—bad investment simply crowds out good investment (Mises). But it is implicitly denied that distorted factor prices change factors' behavior (Mises 2002, p. 188): "credit expansion cannot increase the supply of real goods. It merely brings about a rearrangement." See also Mises (1936, p. 29) and Garrison (1996).

In fact, and somewhat paradoxically, the boom described by Mises (and Böhm-Bawerk) looks more like a slump, for if inputs remain roughly constant and are employed less efficiently, output necessarily falls.

while excluding incentives to engage in short-term ventures.[21] More generally, it remains hard to deny that an increase in aggregate demand for goods and services generated by low interest rates stimulates production in the short run, too; and thus also leads to an increase in demand for primary inputs. Producers are indeed willing to pay a higher unit price in order to meet present and future consumer demands. Meanwhile, input owners react to higher factor prices by expanding supply, because they are indeed offered an opportunity to enhance their purchasing power (inflation is a sequential process).[22] As a result, production expands.

Once more, the above does maintain the Austrian insight, whereby the boom is sparked by monetary phenomena, leads to substantial changes in the capital structure, and generates changes in relative prices.[23] In particular, the presence of intertemporal distortions is confirmed, as agents mistakenly react to the misaligned rate of interest. But it expands the original Misesian view, whereby it claims that relative-price changes affect both investment decisions and—more generally—the markets for production factors. And that new factors are drawn into the production process by the possibility—not just the illusion—of greater remuneration.

Crash and Depression

How far will the boom go on under these conditions? Böhm-Bawerk would have said that the answer depends on when individuals no longer accept postponing consumption and force the market

[21]Lower interest rates provoke higher demand and thus higher relative prices in the consumer-goods sector, as the Misesian theory acknowledges. Of course, agents do not realize that deferred consumption might be below expectations.

[22]Of course, the more agents believe that the boom is sustainable and thereby mistakenly anticipate a permanent rise in purchasing power, the more willingly they agree to increase their supply of production factors. As a side effect, they will be inclined to order goods that will be delivered at a later date, or simply let producers believe they will be ordering such goods in the future.

What is described in the text is not the only possibility, though. It may happen that consumer prices rise as producers demand more inputs, or that consumer prices rise before producers demand more inputs. In the former case, factor supply remains constant since resource owners would be getting the same real remuneration. In the latter case, factor supply would actually shrink. Once again, the real boom would never come to life, or—in the second case—it would actually turn out to be a slump.

[23]This is indeed the essence of the Austrian theory of the business cycle—see Garrison (1981), quoted in Bellofiore (1999, p. XXI).

rate of interest to bounce back, in other words, until consumers start to perceive they had wrong expectations about their intertemporal consumption-possibility frontier. Mises adds that the gap persists until the banks "refrain from any further extension of credit" (Mises 1936, p. 28). Banks will stop doing so when inflation builds up and there appears a real danger that people panic. Even if that may already be too late, since "panic" is actually originated by new patterns of expenditure related to the relative-price structure.[24]

Mises's theory on the end of the boom and the features of the crisis needs to be qualified. History shows that agents do not usually panic unless inflation is acute and characterized by violent and surprising fluctuations. Furthermore, since the real gap opens up when savings climb back to their "natural" level, one has to investigate the dynamics of savings, rather than simply assume that savings follow investment during the boom.[25]

Consistent with the previous paragraphs, it will be argued that the crash depends on the features of the double gap emerging after agents become aware of their mistake: the gap between effective and expected consumption[26] and the gap between desirable and

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[24]That is actually the core of Mises's original contribution to the business cycle theory. For Wicksell had already clarified how the market interest rate can move away from—and actually drop below—its natural level; whereas Böhm-Bawerk had explained that this fall might ignite a boom, the length of which depends on the trade-off between two forces. The market rate of interest tends to fall because of the ongoing injection of fiduciary means of exchange, but tends to rise as forced savings are reduced. Once again, it may nevertheless be useful to recall that the thesis about forced savings is here rejected.

[25]This differs from Garrison (1978), according to whom crisis breaks out when overinvestment is no longer compatible with reduced savings. Indeed, Garrison's view departs from Mises's in that the latter rules out both overinvestment and a savings gap, consistent with national-accounting identities. Garrison's thesis also differs from what is argued in this paper, whereby crisis breaks out when consumers realize their mistaken behavior and reduce their propensity to consume.

As a whole, there is indeed some confusion about what triggers the crisis in the Austrian cycle—reserve requirements in the banking sector or adjustments in agents' behavior. In particular, Schumpeter's interpretation of the Austrian theory of the business cycle has some responsibility. See on this Bellofiore (1999, pp. XXI–XXIII).

[26]If consumers had realized right from the beginning that their marginal rate of time preference is above the marginal rate of return on investment, they would have reacted relatively early. Then, credit would have been tighter and the market interest rate would have shot up. Hence, the business cycle

expected production capacity. In other words, crisis as traditionally understood breaks out only if substantial excess production capacity comes to the surface, so as to force producers to scale down their activities and possibly go out of business. The adjustment costs incurred in connection with the resources released by such producers are the essence of the slump (depression). The key to this process is provided by the factor markets.

If the injection of currency credit takes place only in period 1, and reverse seigniorage is negligible, then money wages in the various industries change following the inflationary sequence.[27] As time goes by, the real wage rate falls from the levels attained in the early stages of the boom. Then factor supply shrinks and production falls back. For the boom to be sustained the quantity of the fiduciary means of exchange must be increased further, possibly at an increasing rate, to offset the decline in the real factor prices. But the moment comes when the ratio of currency credit to money is high enough to make reverse seigniorage credible. Fiduciary means are no longer issued, inflation gradually dies out, and the interest rate creeps back to the initial rate, while real factor prices make their way to their natural level and resources are no longer available to the same extent as before. Production thus contracts. In short, the end of the boom leaves producers with the overextended investment projects that were triggered by low interest rates, and encouraged by misconceptions about consumers' demand.

Clearly, the characteristics of the crash (from overproduction to natural production and possibly below, due to adjustment costs) necessarily become rather complex and depend on several variables:

- how quickly and deeply agents change their consumption patterns;
- how factor supply behaves;
- how banks act once they perceive that the boom is no longer sustainable;
- how the government behaves so as prevent agents from running away from fiduciary means of exchange;

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would not have been substantial and could not have lasted more than a few months.

[27]It is worth emphasizing that from the monetarist perspective inflation leads to an illusion: factors' owners believe that higher nominal input prices reflect higher real prices. From an Austrian perspective factors' owners who experience the inflationary sequence at the beginning of the inflationary period are not fooled at all. They are definitely offered a higher remuneration.

- how much excess capacity has been created; and
- how important adjustment costs turn out to be.[28]

As regards depression, the Austrian terminology refers to the period of time during which production is below the level associated with the natural amount of capital, i.e., with the equipment operating under long-term, natural-interest-rate conditions. In Mises's approach (1928, p. 136) noninvested savings explain depression, so that after the crash the economy allegedly suffers from undercapitalization. In particular, the early-Austrians attribute undercapitalization both to malinvestment, whereby short-run accumulation has been transformed into long-run investment projects, and to those producers who went out of business during the crash, thereby destroying the capital projects they had launched.

Still, this view raises two problems. First, if one accepts that producers are fooled by the interest-rate dynamics during the boom, and they wrongly anticipate greater aggregate demand, it is then difficult to conceive a situation whereby producers expand their production plans and yet suffer from undercapitalization after the boom is over. Indeed, an economy is usually deemed to be "depressed" because investors are hesitant about new investment ventures and fear to be over-, not undercapitalized. Second, low investment does not imply lower production (depression), but persistently low or zero growth. Thus, if Misesian economics aims at explaining depression after the crash, it must necessarily investigate the nature and magnitude of resource mobility across industries, companies, and projects. Otherwise, a post-boom economy inevitably falls back to its steady-state condition (the evenly-rotating economy).[29]

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[28]The implicit assumption is that there exist significant transaction costs. Mises (1912) is indeed aware of the fact that capital is not perfectly mobile, but he does not dwell on the full implications of such a statement; nor does Kirzner (2001, p. 142) almost a century later. For both authors continue to perceive the boom as a reshuffling of investment projects, as if producers had gone crazy and replaced good projects with bad projects during the boom (Mises 1936, p. 29). Thus from an early-Austrian perspective the cost of the crisis equals the foregone benefits from not being able to move resources from bad to good projects. Had Mises recognized that the boom also involves an expansion in the number of projects undertaken, he would have realized that investors do not lose their money because the imperfect mobility of capital prevents them from shifting resources from bad to good projects. Instead, they get into trouble because they have sunk resources in unprofitable ventures.

[29]As stated at the beginning of this article, the term stagnation is avoided because of its ambiguity. If by stagnation one means a situation where the

The first puzzle is actually solved by focusing on factor supply, which rises during the boom and falls back during the crisis. Depression is then indeed characterized by overcapacity, due to excessive past commitments to invest; and also by undercapacity, due to the unexpected scarcity of some essential inputs—say labor. Put differently, the early-Austrians are correct in claiming that depression is the result of scarce production capacity. Such scarcity is however generated by factors other than equipment. Malinvestment problems do arise. But rather than being associated only with temporal mismatches, technical inconveniences will also cause serious—if not more serious[30]—trouble. In particular, given the unanticipated dynamics of factor supply, it is quite likely that investment projects undertaken during the boom contemplate—say—labor-abundant techniques, whereas the crisis is going to reveal a situation requiring labor-scarce techniques. If so, it may then happen that for a relatively long period after the boom is over, producers continue to overpay production factors other than capital, since that may still be preferable to leaving equipment idle or badly exploited. That will obviously slow down the decline in real wages and employment and make adjustment last longer (depression or stagnation).

These remarks also help answer the second question. Depression occurs in the aftermath of the post-boom crisis. In particular, the Austrian approach suggests that the origin of depression lies with what keeps entrepreneurs from adjusting to the new economic climate. Still, when the boom ends up in a crash, entrepreneurs react to their past mistakes and adjust: performance improves and thus recovery gets under way. In short, in this case it would be more appropriate to refer to "crash and (more or less gradual) recovery," rather than to depression.

Hence, if depression applies to a situation where production remains below potential output, two nonexclusive explanations may be put forward. First, agents may discover the illusory and dangerous nature of the boom only gradually, so that the end of the boom is not a crisis, but rather similar to a soft landing. If so, the use of the word "depression" would be misleading, since it would take as a

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economy is below its "natural" potential, then it is depression. If on the other hand it refers to a situation where the economy fails to grow, then this is either because the "natural" growth is zero (lack of entrepreneurship), or because the negative dynamics in factor supply offsets the effects of technological progress. In neither case does the term stagnation help to clarify the nature of the problem. Indeed, it contributes to the confusion.

[30]Accelerating or slowing down an investment plan may be easier (less expensive) than changing the nature of the investment project.

benchmark the peak of economic activity reached during the boom, rather than its "natural" level. And one should also examine what may prevent an economic system from bouncing back—even if at a slow pace—after the crash. For although the mechanics of the slump below roundabout-production standards may be clear enough (adjustment costs), the reasons for failed recovery remain obscure. This is where the second element—institutions—comes into the picture. Institutions are indeed likely to be of great consequence, although surprisingly neglected by much of the early-Austrian literature on the trade cycle.[31]

POLICIES

Mises clearly considers the business cycle detrimental to economic activity. Resources are wasted as bad investment projects are pursued and then reshuffled again in order to adjust to fundamentals. Mises does not believe that the business cycle can be eliminated. Nevertheless, he feels that experience and greater awareness about the damages provoked by the cycle may help agents' ability to monitor and anticipate misbehavior by the banking sector. To that purpose, he favors a qualified version of free banking, which in his view is equivalent to some kind of constitutional prohibition for the state authorities to print money in order to save bad banks during a crisis. And he is also willing to accept regulation as a way to discipline the banking sector (2002, pp. 151, 175)[32], although he recommends that governments abstain from supplementing expansionary policies with wage-rate legislation (rigidities) and protectionism.

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[31]Mises's view on free banking actually goes in this direction. Banks that are excessive in issuing fiduciary means of exchange and/or lend it to bad investors are going to be punished by the market. That would limit the cycle, since fiduciary means issued by a bad bank would not be accepted in the first place. They could never become a substitute to money and they could not contribute to distorting relative prices. Mises is right, of course; but while he emphasizes the institutional element at the beginning of the cycle, he is not equally assertive when dealing with depression (failed recovery) and the way the phenomena are related.

[32]Instead, Mises believes that cooperation and ultimately collusion would nullify the benefits of competition on an international scale. This explains why the early-Austrians by and large neglected to differentiate between open-economy and closed-economy versions of the business cycle. To be precise, the difference is not really between open and closed economies, but rather between monetary systems based on *fiat* money and gold.

By pursuing this last insight it is here maintained that banks are not the only culprits and perhaps not even the main culprits. Indeed, Mises is perhaps too hasty in accusing government intervention of merely expanding the money supply in order to save banks on the verge of bankruptcy (1931, p. 204). For policy making can ignite the boom independent of the banking sector and can aggravate its aftermath—crisis and depression—in many ways other than money printing to replace fiduciary means.

In accordance with the interpretation put forward in these pages, the real world shows that booms are usually characterized by an expansion in both consumption and investment. Employment of new resources is an essential component of the trade cycle. Understandably, when the boom is over and real factor prices decline, their owners tend to react and defend their newly-acquired rents.[33] This applies to members of both concentrated interest groups (who provide intermediate consumption goods) and dispersed groups with voting powers (labor). Hence, pressure to transform a competitive surplus into a rent rises and might lead to legislation favoring wage-rate and labor market regulation, barriers to entry in selected industries, privileges to the incumbents. As a result, crisis leaves producers with relatively high factor prices. They will then react either by asking for subsidies and appropriate rescue programs, or by filing for bankruptcy and possibly starting anew. The latter option will of course be more appealing, the more difficult is the struggle with the new legislation given an old production structure.

Put differently, during "normal" crises producers suffer from overinvestment. They tend to adjust by reducing accumulation so that a new equilibrium is obtained, whereby real input prices decline. Both equipment and output fall back to their roundabout-production levels and compositions. Of course, that is not necessarily inconsistent with a relatively soft landing. However, if the government intervenes by stopping factor prices from declining, producers have greater incentives to leave equipment idle and file for bankruptcy.

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[33]As mentioned earlier, the owners of inputs are indifferent between supplying or not supplying resources only at the margin. Infra-marginal suppliers are enjoying a quasi-rent, which changes directly with remuneration. Thus, a fall in the real wage rate leaves the marginal worker indifferent (staying idle provides roughly the same amount of satisfaction as working for the previous wage rate), but not for those who are willing to keep working for a lower real wage rate.

See also Cochran and Call (2001), who draw attention to the role played by price rigidities during the crisis.

Sooner or later these entrepreneurs may engage in new, more capital-intensive projects, which would enhance the productivity of other factors. Under these circumstances one would thus expect a cycle characterized by a boom and a magnified crisis *cum* regulation. The chances for a speedy come-back from the crash will then depend on the barriers to exit and to entry, as well as to the complementarity between the desired (say—labor saving) equipment and the available labor force. The lower the quality of the existing human resources, the lesser the chances for recovery, and the greater the temptation for entrepreneurs to look for rents (privileges) or to move elsewhere—to areas featuring less stringent regulation and/or better human capital. Should this be the case, the crash might easily become depression, as net rent-seeking efforts intensify and domestic investment falls significantly or even becomes negative.

This view also helps explain why a nonmonetary boom may also end up in stagnation and possibly depression. Suppose that a cluster of technological breakthroughs leads to a wave of (*ex post*) unjustified optimism about future growth.[34] As a result, when euphoria evaporates and plans are scaled down, factor demand drops. If the government accommodates pressure by factors' owners (or, more generally, it tries to exploit a latent demand for rents), the crisis is sharpened and recovery is replaced by depression. Ultimately, an otherwise normal change in business conditions is transformed into a cycle.

All the above is not quite what the early-Austrians had in mind when dealing with the trade cycle. It is however fully consistent with the overall Austrian approach to economics, whereby growth is driven by individual behavior (which is subject to mistakes) and hindered by government interference. In particular, the role attributed to the dynamics of factor supply makes clear that a business cycle can be set into motion even without deceptive monetary policies. Indeed, all policies that develop their effects over an extended period and affect distinct groups of agents in different ways over time may start a business cycle. Its consequences depend on how the authorities react once the illusion is over and agents struggle to maintain the

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[34]For instance, entrepreneurs and investors may underestimate transaction costs, or resistance by the "losers" in the competitive process, or rent-seeking pressures; or they may mistake the speed or width of a technological advance.

See also Cochran and Call (2001) and Cochran, Call, and Glahe (2003) for different ways to integrate real and credit cycles—as well as sustainable and unsustainable growth—within an expanded version of the Austrian business cycle.

benefits enjoyed earlier, or just to avoid the cost of adjustment, including those related to malinvestment.

The early-Austrian solutions to avoid the trade cycle were straightforward. The illusion of the boom can be nullified by free banking, so as to discourage commercial banks from creating currency credit, which is at the origin of the interest-rate gap. Of course, Mises's goal was to stop any central authority from stepping in, printing new money and making sure it would be accepted as legal tender, so as to avoid reverse seigniorage. For the essence of free banking is not to provide a monetary instrument with a sound backing, but rather a monetary unit ultimately backed by the assets of the shareholders of the issuing authority.[35]

As regards the aftermath of the boom, the early Austrian School argues that the best policy is to abstain from any anticyclical program, and allow the market interest rate to go back to its normal level without further pushing agents to take the wrong course—malinvestment.

The extended version suggested in the previous pages maintains however that free banking or a gold standard are not enough to stop a boom from taking off. As recalled earlier, there are other ways by which bad rational decisions can be provoked, either by a central authority or by interest groups that will be credibly backed by central authorities in the future. Furthermore, from a static viewpoint, moderate money printing[36] is not necessarily worse than reverse seigniorage. More importantly, one should make sure that policymaking remains modest (or absent) during the crash, when demand for political services is going to be greater. The obvious conclusion is thus that one should take advantage of the boom to enhance free-market rules, and make it expensive to renege upon them later. If

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[35]Of course, the fundamental weakness of a free banking system as it is advocated today is that a central authority would ultimately emerge as the winning competitor in any country with a relatively strong government. For such authority would be backed by a monopoly on violence, and thus by the power to tax and force people to accept a given unit, even when some have other preferences.

[36]The term moderate refers to a substantial enough issue of new money, so that a soft landing becomes feasible; but not large enough to seriously undermine the credibility of the currency and provoke a change of the unit of account (dollarization). Money printing remains of course a serious problem from a dynamic perspective, for this policy surely acts as a powerful incentive for rent-seeking groups to disrupt the economy, enjoy the benefits of mistaken behaviors and avoid most of the cost.

anything, international organizations should then forget about providing supra-national rules to govern the market and smooth its alleged excesses, and rather act in order to de-legitimate national policies. History shows that freedom to move and to choose (institutional competition) is the best guarantee against stagnation and depression.

CONCLUDING REMARKS

As recently recalled by Oppers (2003) the Austrian theory of the business cycle has been marginalized by the Keynesian revolution and the New Deal. There are empirical, ideological and theoretical explanations for this. From a factual viewpoint, the Austrian approach has failed to provide a convincing explanation of the trade cycle at a time when the creation of currency credit is no longer a secret and may actually be controlled with relative ease, for instance, by means of globalized capital markets, which have created a system dominated by competing currencies (issued by central banks, rather than by commercial banks). In other words, during the post-war period the Austrian emphasis on the banking sector as the main actor behind the business cycle has not been very persuasive. Although monetary policies have not always been predictable in a long-run perspective, financial markets have produced a wide range of instruments that can protect operators from bad expectations and unreliable actors. Indeed, it has become increasingly difficult for any banker to influence the real market interest rate by the creation of substantial quantities of fiduciary means of exchange. More sensibly, in the past decades central bankers have tried to follow the market, while commercial banking has tried to guess about future market conditions. At most, some have tried to "beat" the money market. Not many believe they can steer it any longer, unless for a very short period of time. In short, although the early-Austrian would not have denied that policy-making on the real side could explain parts of the business cycle, their emphasis on the monetary side was surely a breakthrough at least in the first part of the twentieth century, but perhaps a liability in more recent times.

From an ideological viewpoint, focusing on the banking sector as the main actor of the business cycle and advocating some kind of restraint imposed from a supposedly benign authority has not helped. Instead, it has led to advocating a stronger role for an independent central bank and ultimately enhancing tighter cartel-like agreements within the banking sector under the guarantee and the protection of the central bank. Of course, this is almost the opposite of what Mises would have liked to see. Still, by focusing on banks'

misbehavior and providing only half-hearted support to free-banking solutions, rather than stressing the role of regulated capital markets and legal-tender legislation, Mises's theory has offered little resistance to escalating supervisory bodies.

Finally, the early-Austrian version is not immune from some critical ambiguities. For instance, by keeping aggregate supply constant Mises's cycle turns out be an inflationary problem with constant—if not declining—production and bad investment plans. Of course, one cannot deny that stagflation does occur. But this is hardly what one typically characterizes as a boom. For a real boom to come into being one needs expanded production, possibly of both consumer and capital goods. This is possible only if new resources are drawn into the production process and output expands. Still, such possibility is ruled out by the early-Austrian assumptions. In addition, three other more specific issues are likely to remain without a satisfactory answer. First, if the real problems of the business cycle are linked to what has been here defined as the interest-rate gap, and if both aggregate supply and investment remain constant, then consumption also must be constant. Yet this contrasts with what the (Austrian) theory of intertemporal consumption suggests, whereby if the current rate of time preference is higher (lower) than the market interest rate, then consumption increases (falls). Second, according to Mises's approach a crisis goes off when investors find out that their time horizon is wrong. Still, since that time horizon was based on (too generous) credit conditions, that actually means that banks—rather than producers—get into trouble. This is not necessarily a flaw in the early-Austrian story. Nevertheless, such a story would probably be more persuasive were it presented as a banking cycle, rather than as a general business cycle. For a banking/financial cycle to become a business cycle one needs to spell out the connections between the real and the financial sector—the transmission mechanism—in greater detail than the early-Austrians did, and distinguish the overall changes in economic activity from "mere" redistribution. Finally, although the early-Austrians were persuasive when emphasizing the role of capital during the boom, they were less so when tackling the crisis. There is no doubt that a period of expansion is usually accompanied by a higher propensity to undertake risky projects, possibly with longer time horizons, and that decisions along such lines may cost dearly during the crisis. Still, according to the early-Austrian view one should expect excess supply of high-order goods and excess demand of low order goods. One may overlook the fact that this prediction is simply not consistent with the real world. But from a theoretical perspective one does not understand why long-run projects cannot be accelerated. More generally, the way the notion of low- and high-order goods is applied seems to be questionable.

Despite the doubts that may cloud part of the conclusions drawn from early-Austrian theorizing, the Misesian foundations—sequential inflation and the role of the interest-rate gap—remain sound and promising. In particular, it has been suggested here that the chances for a revival of the Austrian insights depend on the ability to expand Mises's theory to include the economics of the factor markets as well as of rent-creation. This does not present major difficulties from a methodological viewpoint, since both the Austrian theory of inflation and the Austrian emphasis on the economics of institutions are already in place and can provide the necessary guidelines. Surely, it opens up new research agendas for the future.

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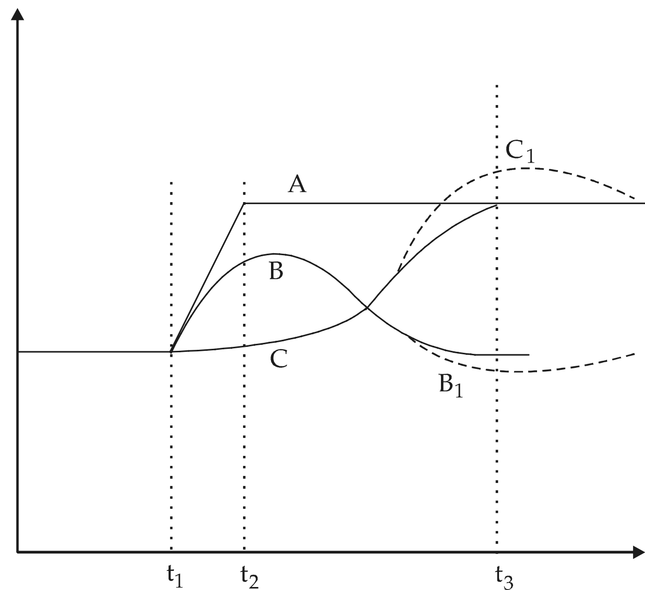
APPENDIX 1

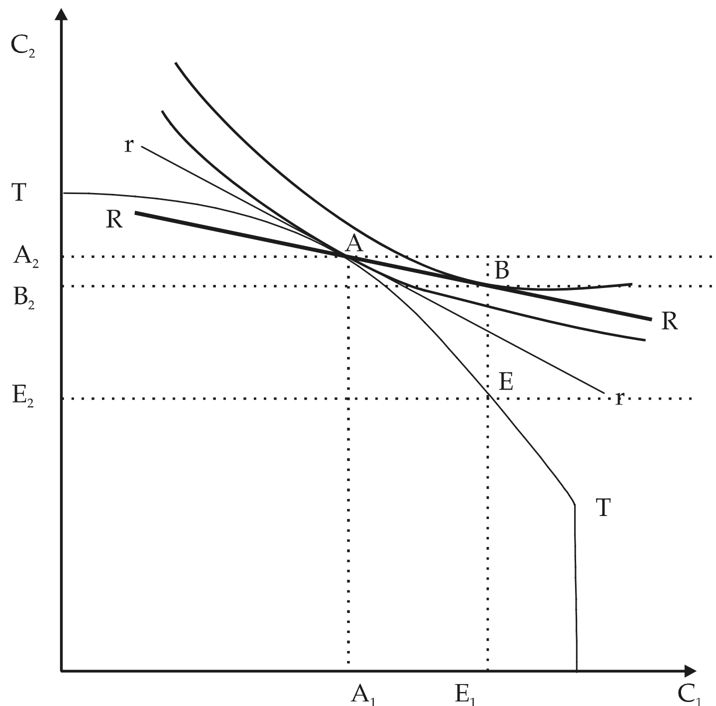


Given constant output in real terms, curve A describes the dynamics of the monetary shock, which starts at time t_1 and is sustained until t_2. Curve B refers to the dynamics of real demand for money after the money supply starts to increase, while C describes the dynamics of the price level. Due to sequential inflation, money demand rises, excess demand for goods grows fairly slowly and prices are thus prevented from adjusting to the new monetary conditions immediately.

As the inflationary process follows its course, demand for real money falls back and prices reach their new level (see t_3). As mentioned in the text, if agents believe that money supply is bound to increase further, demand for real money balances may undershoot its final level, as described in B_1. If so, excess demand for goods will not vanish at t_3 and the price level will overshoot its long-run level (see C_1).

If real income is constant, nominal income will follow the same dynamic as prices (C or C_1).

APPENDIX 2



The graph above describes the world Mises has in mind when describing the trade cycle. In particular, preferences, technology and production factors are constant. That explains why the indifference curve maps as well as the position and shape of the production-possibility frontier remain constant throughout the cycle.[37]

Axes C_1 and C_2 describe the quantity of consumption goods available at time 1 and at time 2 in a closed economy. Point A is the initial situation, where the market interest rate is equal to the natural interest rate, and A_1 and A_2 denote consumption at time 1 and time 2, respectively. TT is the production-possibility frontier, the slope of which is the marginal rate of transformation.

As agents observe the market rate of interest fall (from rr to RR), they see they can improve their well being by moving the intertemporal consumption distribution from (A_1,A_2) to B (E_1, B_2). This means

[37]Should new factors be drawn into the production process, the transformation curve would shift outward and probably change its shape, too (the marginal rate of transformation).

that they are induced to increase current consumption (from A_1 to E_1), since they believe that this entails a relatively small sacrifice in terms of deferred consumption (A_2-B_2), which is worth the effort, given the relatively high rate of preference typical of A.

However, since nothing happened from the technological viewpoint, the marginal rate of transformation has remained constant. In fact in order to satisfy higher current consumption, deferred consumption shrinks from A_2 to E_2, rather than just to B_2, as consumers mistakenly believed.

Therefore, the boom comes to an end in period 2, when consumers realise that their plans were assuming a level of intertemporal welfare that has turned out to be incompatible with the production-possibility frontier. As they find that their behavior corresponds to E (E_1,E_2), they realize that their marginal rate of intertemporal substitution is lower than the marginal rate of transformation. As a result, they reduce consumption and raise their savings.

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ESTABLISHING GOVERNMENT ACCOUNTABILITY IN THE ANTI-SWEATSHOP CAMPAIGN: TOWARD A LOGICAL, ACTIVIST APPROACH TO IMPROVING THE WORKING CONDITIONS OF THE POOR

ELLENNITA MUETZE HELLMER

ON COLLEGE CAMPUSES ACROSS the country, there has been an escalating uproar concerning labor conditions in less economically developed regions of the world. Many student organizations—such as the United Students Against Sweatshops (USAS)—propose to improve the conditions of the world's poor by boycotting clothing made under the "sweatshop" conditions in which many of these poor labor.[1] Such organizations demand that foreign-owned corporations improve the wages and working conditions in poorer regions of the world, and enact boycotts or lobby for legislation that will forcefully implement these initiatives.

Economic theory, however, suggests that such actions are misguided. Indeed, it is hard to make the case that there is something wrong with people working for wages that others find abhorrent when these laborers are very poor and have few other options; if a laborer is working for extremely low wages it is his way of pursuing his best perceived option, and concurrently the market's way of

Ellennita Muetze Hellmer has a masters degree in social science from the University of Chicago. Although he does not agree with many of the points here, and, indeed, I explicitly criticize his views on the subject, I still wish to thank Walter Block for his assistance in the preparation of this article. The usual caveats apply: all errors are my own responsibility.

[1]The definition of what a "sweatshop" exactly is can vary, but it is generally any type of factory in which workers work very long hours for very little money under conditions that are perceived by some to be less than adequate to assure worker health and safety.

allocating scarce resources efficiently given the supply of labor and the demand for the laborer's product. Generally, low wages are "just" as the laborer and the employer freely agree upon them. It would therefore seem misguided for a third party to step in and make a value judgment concerning this agreement based upon some illogical interpersonal utility comparison. Indeed, economic logic suggests that it is actually harmful for third parties to demand higher wages and better (more costly) working conditions for the poor, as such demands will result in unemployment among the most disadvantaged, given that these measures seek to raise wages above the going market price. Tragically, many efforts to violently enforce improved working conditions in developing nations before these conditions emerge through the market process will also ruin the comparative advantage of poor nations and thus an important opportunity for economic development.

Given these points, many observers—especially libertarians—tend to view the actions of such student organizations as USAS as actions arising from an ignorance of basic economics (e.g., Block 2000). However, it is not necessarily correct to entirely dismiss the sense of injustice felt by these groups. Although these organizations may be misguided in only attacking the wages paid by corporations, the claims of injustice are not always fictitious, not by a long shot. In some countries, such as Burma/Myanmar, workers are forced by the state to work in miserable manufacturing jobs for powerful multinational corporations (*The Economist* 2000; Amnesty International 2004). In other countries, such as Indonesia and several of those in Central America, governments have followed models of economic development that forced people from their land in order to attract multinational firms to export goods to the global economy and give the politicians a cut of the profit (Abrash 2003, p. 392; *South-East Asia Mining Letter* 1995; Booth and Walker 1999). These models of sweatshop development do not follow the free-market ideal of resource allocation mentioned above. There is a link between such utilitarian models of economic development and slavery, as the former is a government's way of violently forcing people to follow a model of economic action that these people would not agree to otherwise—presumably because they do not see the model fitting their best interests. Indeed, in these cases protesting voices should be heard, as governments are clearly violating the personal and property rights of individuals.

As many of the goods produced under these conditions are exported to the global economy, libertarians and other humanitarians should educate themselves about the conditions under which they are produced in a way that extends beyond the basic use of

free-market teleology to explain why some people work in miserable conditions.[2] Indeed, acknowledging that governments are often responsible for the plights of "sweatshop laborers" is an important step in fighting for the economic and civil liberties of people throughout the world. This step goes beyond the band-aid propositions of "corporate social responsibility" put forward by many anti-sweatshop organizations by addressing the real cause of miserable working conditions in many parts of the world. Anti-sweatshop organizations would therefore be better advised to focus on the government actions that have led to the miserable labor conditions that they are so fond of describing, thereby protesting these as the real cause of much of the misery evident in the developing world. Indeed, a fight for private property and personal protection against coercive aggression would be a more sustainable, logical, and economically literate approach to improving the conditions of the working poor of the world.

BACKGROUND ON ECONOMIC THEORY

Anyone who has sat through Microeconomics 101 knows that a refusal to buy certain goods (in the form of a boycott, regulatory legislation, etc.) does not necessarily help poor workers, nor do demands to raise wages above the market-clearing price. Aside from the seemingly intuitive idea that a boycott may result in the loss of jobs for many poor workers, extra-market measures (such as minimum wage laws and state legislation enforcing certain working conditions) set a floor on wages. A wage floor that is higher than the wages paid to labor in a free market creates a surplus of labor (unemployment), as it compels employers to hire fewer workers than he or she would at a cheaper price for labor. Thus the demand for labor becomes less than the supply of labor attracted by the high wages. In this case, workers are in turn attracted to and shut out of the market for labor, as the price distortion created by the wage floor has signaled to them that more workers are needed, but they are shut out by the wage-inflexibility imposed by outside forces.

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[2]In *Human Action* Mises (1949, p. 107) claims that the sciences of human action (such as economics) are entirely ruled by teleology. The only observation that can be made about action is that, in order to act, a human must feel discomfort and believe that a chosen action must be the best way to improve his condition. Many economists apply this reasoning to explain the phenomena of sweatshops by pointing out that laboring in a sweatshop must be the most beneficial option that a laborer can pursue, or else they would not do so. Therefore, these same economists reason, these sweatshops are indeed the best thing for the worker, and dismiss any further ethical discussions about the matter.

When discussing fair wages, it is also necessary to go beyond basic supply and demand analysis and recognize that an employer cannot pay more to the worker than what the worker has produced, as that would lead to eventual bankruptcy. Nor can an employer pay the workers less than what they rightfully earn through their marginal revenue product, at least not for long. If an employer were to pay a wage earner far less than what the worker produced for the employer, there would be a high turnover rate as other profit-seeking firms compete for the cheap labor, and the initial employer would be pressured to raise wages in order to hold onto his labor force. Thus wage-rates in a free market tend to equal the marginal revenue productivity of labor.

Indeed, we can see this process occur in the developing world. In most poor nations, there is a surplus of labor, so unemployment, poverty, and even starvation ensue. Since there is such a surplus of workers relative to the number of available jobs, the price of labor is very cheap in many of these countries, allowing corporations the luxury of a small overhead and a large profit if they hire poor laborers to manufacture their goods, which they in turn sell for a price that is much greater than the cost of production. However, the logic of economic action shows that this is not a sustainable situation—good news for impoverished and unemployed laborers. As corporations struggle to stay competitive and maximize profits, the disparity between the costs of production and the sale price of a given good that occurs when manufacturing is located in a poor nation attracts more firms to these countries. When this occurs, more jobs become available and the surplus of labor diminishes. Eventually, firms have to compete with each other in order to hire the best workers, a process that bids up wages, benefits, and labor conditions in such a way as to vastly improve their condition. The sweatshops, then, are a necessary step toward a sustainable economy that provides good jobs for what were at one time very poor and desperate people. Efforts to keep multinational corporations from locating manufacturing or other activities in foreign countries and efforts to reduce the profitability of such action prevent this beneficial process from occurring.

Given this logic, it is assumed by many economists to be silly to protest against sweatshop conditions. More expensive labor conditions and higher wage rates than those allocated by the market cause unemployment and hinder economic development, especially in poor nations. It is also fallacious to criticize the voluntary choices made by individuals in different areas of the world just because those actions have not resulted in what the subjective observer considers to be satisfactory economic conditions, as this involves an interpersonal utility comparison that no one but an omniscient God is qualified to make.

However, it is a quantum leap to go from the perfect *a priori* economic logic presented above to the real world and assume that this *ceteris paribus* logic always applies. Often, the harsh facts of global political economy do not follow the rules of free-market theory as the prerequisite of voluntary choice is often absent; people are sometimes kidnapped and forced to labor by their governments, and property rights are not always respected. While the above activities do not prevent individuals from pursuing what they believe to be their own best-interest, it is not reasonable to defend their choices and ignore the previous injustices that have led to their current state if one is to make a humanitarian argument against interference in the market. In a world in which personal and property rights are always respected, the logic of the economic libertarian is impeccable; however, advocates of this philosophy should continuously remind ourselves that this is not always the context in which real suffering people (especially in underdeveloped nations) operate when we demand that corporations be allowed to benefit from the differing legal systems abroad.

THE MULTINATIONAL UTILIZATION OF SWEATSHOP SLAVERY IN BURMA/MYANMAR[3]

The case of Burma provides an instructive example of how anti-sweatshop groups have recognized injustice in the global political economy and have sought to redress it, although being somewhat confused about what the injustice is. Burma has been a major supplier of apparel in the past, especially to the U.S., which consumes 16 percent of all Burma's exports. Apparel imports from Burma skyrocketed during the 1990s, increasing by 272 percent since 1995. This export is a significant source of revenue for the Burmese nation, constituting over 80 percent of all Burmese imports entering the U.S. (The National Labor Committee, 2004). The retail clothing companies in the U.S. that have sold items manufactured in Burma include Adidas, Kohl's, Warner Bros., Bugle Boy, Jordache, and Nautica, a significant group of major low-cost-clothing providers (ibid.).[4]

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[3]Although the military government of this country changed the name to "Myanmar," the democratically elected Parliament does not recognize the name change, and maintains use of the name, "Burma." Due to the support of the democratically elected leaders, the U.S. government likewise uses "Burma," and I adopt this convention.

[4]In 1997, the United States passed a law barring American companies from making any new investments in Burma. But many "grandfathered" companies

Several years ago, students at the University of California, Berkeley and American University organized in order to get items manufactured in Burma pulled from the shelves of the campus stores. After drawing media attention to the issue, the universities decided to pull the goods, and the supplying apparel company (Jansport) requested a return of all its Burmese-made apparel (*The Daily Californian* 2000). The students lobbied for this action charging that the goods were produced under what they charged were woefully unacceptable labor conditions. While a boycott may not have been the most effective means to help the laborers in Burma, one cannot simply dismiss the efforts of the student activists as economic illiteracy, as libertarians are wont to do.

Indeed, a number of other grassroots organizations, including the Free Burma Coalition, Global Exchange, and the Campaign for Labor Rights, have campaigned in the past to use the force of the state to end the importation of apparel made in Burma. Generally, reasons for concern cited are the usual anti-sweatshop rhetoric, most notably contempt for corporate profits. For example, a study by the National Labor Committee (NLC) concerning the source of NBA hooded sweatshirts manufactured in Burma reports that garment workers' wages are as low as 7 cents per hour, and that the workers in Burma are paid just 4 cents for each NBA hooded sweatshirt they sew; their wages add up to less than one-tenth of 1 percent of the NBA's $60 retail price for the garment.

Sadly, however, the NLC and most other organizations miss the linchpin in an attack on the Burmese system of manufacturing. Mentioned (very briefly) in this report is the fact that merely questioning factory conditions can result in imprisonment. This last fact is reasonably well-documented but tragically far from the ony individual liberties violation that is a way of life in Burma. However, it is brushed over by an organization that claims to care for international labor rights.[5] The truth is that the military regime of Burma abducts its own citizens and forces them to work in factories owned

remain, and imports from Burma have increased five-fold since 1997 (The National Labor Committee 2004).

[5]While not a mind reader, my best guess is that the NLC is not trying to draw attention to the plight of the slaves, but to the plight of the workers who would compete with U.S. laborers for manufacturing jobs. Were they to emphasize the difference between Burma and, say, Brazil (that in one country the citizens are forced to work and in the other country the citizens are free to choose), they would be defeating their interest of demonizing all sweatshops (all foreign manufacturing plants) everywhere.

by multinational corporations. Often, the laborers are political dissidents or petty thieves, but the criminality requirement is a mere formality. Many innocent people, as well, are forced to work in the factories as well, bringing the number of slaves to a total of 800,000 (*The Economist* 2000). These forced laborers toil all day in dangerous and disease-ridden conditions under the gaze of armed guards. Often, they are chained together for months at a time. Those who refuse to work are beaten; thousands are raped or killed (Amnesty International 2004). The U.S. and the international community have imposed sanctions on Burma, but the regime and the state-dominated economy continue to thrive.[6]

In this case, it is clear that many of the economic objections made by free-market defenders do not apply. The condition of slavery prevents many of the workers from pursuing better jobs, even when manufacturers move to the country to take advantage of the cheap labor. According to capitalist theory, the high profits made by corporations that manufacture their clothes in less-economically developed nations attract more entrepreneurs who want to further increase their profits, and these new entrants into the Burmese manufacturing market then have to bid up wages in order to entice workers to work for them. However, this logic only applies when workers are free to choose which jobs to work and receive the benefit of their productivity in the form of wages, which is not always the case in Burma. Here, the *government* is often paid by the multinational firms in order to utilize the labor of the prisoners. In such a situation the bidding up of the price of labor does not affect the incentives of the prisoner-workers. Rather, correct economic reasoning suggests that the politicians would respond to the increased demand for their cheap workers by raising the price that they (the government) charge for the labor. The upward movement in prices in turn provides the ruling classes with an incentive to enslave even more workers, *ceteris paribus*. As long as this upward movement in the price of labor allows corporations to maximize profit, they will continue to locate manufacturing in this nation, and this will lead, in a truly vicious circle, to still more enslavement of the population and little increase in the standard of living for the impoverished worker.

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[6]However, we must ask ourselves if the slave labor is what keeps the economy thriving. This is, of course, an illogical assertion. Slaves are necessarily less productive than free laborers; the economy thrives despite slave labor, and would do better without it (Hummel 1996). Although it could reasonably be said that the military regime thrives because of slave labor, that is an entirely different question, yet also a key to understanding the situation.

Many companies, including Levi Strauss, have abandoned manufacturing activities in Burma. According to the Clean Clothes Campaign (2002), a spokesman for the corporation explained that it "is not possible to do business in (Burma) without directly supporting the military regime and its pervasive violations of human rights." It is indeed eminently reasonable to assume that the kickbacks the Burmese government receives from the corporations help keep the regime in power, and that the entrance of new corporate manufacturers into the country entices the government to enslave more people. Levi Strauss seems to have been aware of this fact, and thus abandoned operations. Wal-Mart, IKEA, and Spiegel also publicly announced they would no longer accept merchandise from the country (ibid.).

However, other less ethical corporations continue to subsidize the government by locating in Burma. They are not at all innocent, as some advocates of free enterprise would claim. The coercive conditions under which the people work are well known, as is the fact that these workers are slaves to a repressive government. A legal positivist might argue that, as enslavement is legal in the country, and as the citizens have yet to overthrow the repressive regime, those who utilize the fruits of the military junta's policies cannot be held accountable. However, as long as one believes in a higher morality than the law, this is not a sufficient defense of such morally reprehensible corporate action.

In this case, the overt rejection of a corporate boycott by free-market intellectuals may be a knee-jerk reaction that should be reconsidered. What student groups such as the USAS at the University of California, Berkeley and American University sought to do through their boycott was to make it less profitable for corporations to manufacture in Burma, based on the fact that the workers in this country were slaves. This disincentive to locate manufacturing in Burma would logically lead to a loss of international currency by the military junta, which would weaken their repressive government, which may in turn allow the population to take steps toward a freer society.[7] Acknowledgment of the injustice of violently enforced slavery was a correct action for USAS to take in this situation, even if the focus on low wages and high profits made by other anti-sweatshop groups missed the main reason for protest.

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[7]Indeed, efforts by the United States government to limit the amount of imports from Burma have been denounced by the military junta as damaging to the poor slaves, an ironic and unfortunate use of free-market logic. (Department of State 2002).

BURMA IS NOT AN ANOMALY: GOLD IN INDONESIA AND COFFEE IN CENTRAL AMERICA

The case of Burma is not isolated, although it illustrates that a boycott of a corporation subsidizing an oppressive regime can negatively impact that regime and the policies they implement. Another example of human rights abuse carried out by governments in order to appease benefiting multinational companies is the case of Freeport McMoRan Copper & Gold Inc. in Indonesia. This corporation, too, has been properly demonized by the university activist crowd (much to the discomfort of the economic libertarians).[8]

In the case of Freeport, the company was given permission from the notorious Suharto regime in Indonesia to relocate certain indigenous groups that had inconveniently homesteaded land on top of one if the largest gold mines in the world (Abrash 2004, p. 392).[9] In 1967, Freeport McMoRan moved into the territory and confiscated the land of the Amungme and Kamoro peoples without any consultation or consent by the legitimate landowners, and forcibly relocated them with their own funds.[10] Nor have the forced relocations ended. In 1995, the Indonesian military stated that 300

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[8]In 1996, Freeport McMoRan was regarded as one of the ten worst corporations in the world by *Multinational Monitor* magazine. At Loyola University New Orleans, my alma mater, the creation of an endowed chair in Environmental Communications in 1995 by Freeport CEO Jim Moffet set off a wave of protest. In one famous incident, students picketed the CEO's Garden District home during the evening hours, reciting chants accusing Moffet of murder (Fox 1997). Indeed, the protestors demanded that Moffet take back the money he had donated to the university, a route of action that the CEO unsuccessfully pursued (*The Tulane Hullabaloo* 1995).

[9]When asked about his special relationship with the Indonesian government, Freeport Chairman Jim-Bob Moffett addressed the allegations of cronyism by claiming his company operated according to what was then standard practice in Indonesia under Suharto (*The Times-Picayune* 1999). Moffett also pointed out that Indonesia is not the only place where well-connected people make money from government contracts: "Do you know what FOB is in Washington?" Moffett asked the *Picayune* reporter. "It's Friends of Bill. That's how you get contracts with the U.S. Government—Friends of Bill. . . . If you come to Louisiana it was Friends of Edwin, Friends of Foster. People close to the government have a way of ending up in these deals." The CEO added, "It's rather foolish for a Louisiana newspaper to wonder about cronyism, after we've had an era of Huey Long and all of the people that ran the state of Louisiana."

[10]This tribe of 14,000 people reached an agreement with the company on January 8, 1974, one clause of which forbade the tribes people from entering

families living near a Freeport mine would be relocated (*South-East Asia Mining Letter* 1995). Since the indigenous people that once owned the land now taken over (e.g., stolen) by Freeport's mines are not happy about the interference with their personal and property rights, the Indonesian armed forces have had to create a special task force to protect the mine, one that Freeport publicly acknowledges paying for (*Sydney Morning Herald* 2002).

The United Nations (1999) has found many links between the location of the military in the Freeport area and violence against local indigenous residents.[11] So has the Indonesian National Human Rights Commission (1995), confirming that the Indonesian military operating in and around the Freeport project area were responsible for the murder of at least 16 civilians and the "disappearance" of at least four individuals living in the area. The Commission stated that the violations "are directly connected to [the military] acting as protection for the mining business of PT Freeport Indonesia." While the military in Indonesia is certainly a branch of the government, in this case the government's growing monopoly on "legitimate" violence is expressly financed by the mining corporation. The military does not limit its activities to the direct protection of the mines, but spreads out to the surrounding areas. These land expropriations and growing military violence do not fit into the logic of the free-market theory which would claim that the arrival of Freeport McMoRan was the best thing for the Indonesian citizens. Indeed, if the property rights of the indigenous citizens had been respected by the corporation and the government, the corporation would have either had to buy the land

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certain areas. In compensation, Freeport built a clinic, houses, shops, a market and promised jobs. However, the Amungme people did not realize at the time how harmful this agreement would be (*Republika* 1995). Who could believe that the most expensive gold mine lawyers in the world could trick some unfortunate target into accepting a bum deal? I find the debate about whether or not the Amugme people really sold their land to be irrelevant, as the choice for them was to lose their land and keep fighting, or lose their land and get a free school and medical clinics. This is not a real choice, rather, it was made under duress. Any real sale would have included the option of keeping the land.

[11]Although it is unclear who started this violence, I take the stand that the indigenous groups have every right to use violence to try to gain back the property that was stolen from them, and that it was wrong of the Suharto government to support Freeport's interests over the interests of the indigenous property owners.

fairly in the first place—which would have eliminated the need for escalating violence—and they may have had more respect for the land which they had to pay a stiff price for and not polluted it as much as many protestors claim (Clark 1996).

There is a strong connection between land expropriation and forced labor. Even without the legislation that has been passed in many parts of the world that explicitly leads to slavery, land expropriation forces the original landholders to pursue economic courses of action they would not have pursued if left to their own devices. Indeed, as writer George Beckford (1972) pointed out in his classic work *Persistent Poverty*, few people he has encountered choose to work for others when they own their own land, a condition that makes the land expropriation necessary in the first place. This pattern is most clearly seen in the history of Central America.

By the mid-nineteenth century in El Salvador, the commodity export of indigo, upon which many fortunes had been built, was no longer sustaining the Salvadoran elite, so they turned to the business of coffee production. However, the type of land that is good for producing coffee is quite different from that suited to producing indigo. As a result, the elites who wanted to make money exporting coffee had to acquire new land in the higher, volcanic mountain slopes inhabited by indigenous peasants. In order to acquire this land, the elites legislated communal landholdings (the property system used by the indigenous groups) out of existence. This process started in 1856 when the state decreed that individual communes must plant at least two-thirds of the land with coffee, or be confiscated. Many of the peasants who inhabited the lands suitable for coffee growth lacked the credit, capital, and desire needed to invest in this crop and could not afford to wait seven years for the first beans to give them any returns on their investment. Thus, many of the communal landholdings were wiped out by what amounted to legalized theft. However, some of the communal landholders were able to meet the requirements of the 1856 legislation, so the elites who controlled the state reacted by declaring all communal landholdings illegal in 1880. They also responded to the lack of desire of the now dispossessed peasants to work for them by adding vagrancy laws to the 1880 legislation; requiring that all landless peasants work for the coffee plantations (Booth and Walker 1999).

This is the same pattern of land expropriation and forced labor that occurred throughout Central America from the mid-nineteenth century up until the mid-twentieth century (Block and Yeatts 1999–2000). In Nicaragua, the influential elite began to dispossess the peasantry of their land starting in the 1870s in order to accommodate

the growing demand for coffee abroad. No longer self-sufficient, peasants had few options except peonage on coffee plantations.[12] Land expropriations occurred in Nicaragua under the corrupt Somoza dynasty[13] until the 1950s, when large numbers of peasants were pushed off of Pacific lowland farms in order to make way for coffee plantations that would supply the growing international demand for coffee (ibid., p. 36). In Guatemala, the system of export-led economic development through land expropriation and forced labor began in 1871 under the so-called liberal regime of Justo Ruffino Barrios (1873–1885). Barrios opened up communal landholdings to foreign investment in the interest of promoting modern coffee cultivation in the country (Booth and Walker 1999, p. 45). Once again, those forced off of their lands by the state policies had few other options than to work on the coffee plantations and became slaves to the coffee exporters.

The violent government actions that led to these situations—much like the actions of the government in Burma and Indonesia—resulted in poor working conditions and impoverishment of a group

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[12]In a quantitative study of Central American export-led agricultural development, Swartz and Targ (1989, p. 253) found that agricultural modernization and rural impoverishment were significantly related to political violence. The development of agricultural export production, however, was not found to be a significant determinate of political violence. The authors postulated that:

> Political violence does not result from the development of agricultural export production, but rather from agricultural development that occurs in the context of the inegalitarian transformation of the means and social relations of production and the impoverishment of the rural populace.

I would suggest that the issue may not be the "inegalitarian transformation of the means . . . of production" but perhaps the state coercion that has historically been involved in much of this development, which has prevented most of the population from pursuing what they believe to be in their best interests. Indeed, Honduras is one of the Central American nations that was relatively stable up until the mid-twentieth century. Booth and Walker (1999, p. 51) attribute this to the fact that much of the export-led agricultural development in bananas in previous years did not result from land expropriation. Indeed, most of Honduras's political problems began in earnest after WW II, an event which also coincides with additional forced expropriation of small landholdings by larger agricultural corporations.

[13]This is a regime which, much like that of Suharto in Indonesia, was supported by foreign government wealth transfers (otherwise known as foreign aid), especially from the United States Agency for International Development (USAID).

of people for the sake of providing a profitable export that may not have been produced otherwise. Protesting voices should therefore be welcomed in a humanitarian debate, for land theft and forced labor cannot be justified under any ethic.

CONCLUSION
PROXIMATE AND ULTIMATE CAUSES

Frédéric Bastiat once said that the difference between a good economist and a bad one is that the latter considers only the immediate visible effects of a given policy, whereas the former is also aware of the secondary effects (Stroup and Gwartney 1994, p. 11). We could apply this reasoning in reverse to an evaluation of social justice movements: the difference between a good analyst of justice and a bad one is that the former is aware of the primary causes of a bad situation, whereas the latter only sees and seeks to redress the secondary effects, without realizing the primary cause of the situation. In the case of sweatshop and agricultural labor in the developing world, for example, demanding higher wages for the working poor may have negative secondary effects which many activist groups do not consider, and do not seek to redress the primary cause of impoverishment. The demands for corporate social responsibility seek to redress the role of corporate complacency in contributing to the destitution experienced by many in the world, but is ultimately an oversight of the ultimate cause of this situation, which is government exploitation and lack of respect for personal and property rights.

To look at the situations mentioned above and see low wages and poor working conditions—and ultimately the free market—as the causes of misery is alas too simplistic, as it fails to recognize the ultimate causes: government violations of rights. While it is certainly fallacious to advocate further government intervention to redress human misery, it is also misguided to analyze the situation of misery and state that there is no good reason for protest (see Block 2000). Attacking the corporate supporters of oppressive regimes is a way to ultimately undermine the regimes, which may be one step on the road to fighting for the liberty of people throughout the world. However, if social justice organizations want to be more effective in pushing for greater respect for human rights throughout the world by punishing the corporations that support oppressive regimes, they should make a distinction between voluntary actions of individuals and the state policies that force people into work. The former deserves respect, while the latter is deserving of reproach. By making this distinction, social justice advocates can more effectively push for human rights through the respect of freedom while simultaneously

allowing developing nations and the citizens therein to fight their way out of poverty.

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THE CORPORATION AT ISSUE, PART I: THE CLASH WITH CLASSICAL LIBERAL VALUES AND THE NEGATIVE CONSEQUENCES FOR CAPITALIST PRACTICE

PIET-HEIN VAN EEGHEN

IN AN ARTICLE PUBLISHED in this journal, Walter Block (2002, pp. 3–36) is rather scathing about Henry Simons's credentials as a champion of free enterprise.[1] But it seems possible to be considerably more generous to Simons than Block is, and to regard him as significantly less unlibertarian than Block does, which is not to deny that many of Simons's policy proposals cannot be squared with classical liberal or libertarian principles, or that much of Block's critique is justified. Key to a more charitable consideration of Simons is to keep his overriding concern in mind: that an inconvertible fiat money system and the corporate form of the private business organization are inconsistent with classical liberal or libertarian premises. According to Simons, it is the combination of these two institutions which is mainly responsible for some of the more significant negative side effects of modern capitalist practice, like undue cyclical instability and excessive inequality of income and wealth. Unfortunately, while Simons does propose to prohibit fractional reserve banking, he does not advocate a repeal of the private right to free incorporation, but regularly seeks refuge in state intervention to address the negative side-effects thereof. That is how he strays into illiberal and unlibertarian territory, from which Block takes his cue.

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[1]Henry Simons was not a prolific writer. Most of his ideas are contained in a single volume, *Economic Policy for a Free Society* (1948). For an exhaustive bibliography of Simons's work see Bowler (1974, pp. 7–11).

Even so, one can still credit Simons for pointing out the inherently illiberal and unlibertarian nature of inconvertible fiat money and free incorporation for private business concerns. These insights are significant because they enable classical liberals and libertarians to reject the common socialist view that undue cyclical instability and excessive inequality are intrinsic to a free enterprise system, and they make it possible for us to attribute these ailments to the agency of institutions that are foreign to a classical liberal or libertarian order. While opposition to inconvertible fiat money is an almost standard element of the current libertarian credo (Block, of course, has contributed significantly to the relevant literature), it is far from standard for libertarians or classical liberals to oppose free incorporation of private business concerns, although there are some noted exceptions. Van Dun (2001, p. 31), for example, recently remarked in an article published in this journal:

> [M]ost liberal writers exhibit rather mechanical "free-market reflexes." . . . With respect to large, publicly traded corporations, the common liberal opinion seems to be the one propagated by Robert Hessen, *In Defense of the Corporation*, . . . and Armen Alchian [et al.] *Business Ethics*: large corporations are merely the outcome of efficiency-seeking behavior in a regime of freedom of contract, and are, in any case, effectively disciplined by "the market," especially "the market for corporate control"—hence, presumably, corporate power is nothing liberals should worry about. . . . [I]t is far from clear that large corporations can be seen as conforming to the requirements of natural law.[2]

Block attacks Simons's opposition to the corporation and defends that institution exactly along the lines indicated by Van Dun as quoted above. Block's treatment of Simons is unduly harsh, precisely because he fails to appreciate the illiberal and unlibertarian nature of allowing free incorporation of private business interests, which thus presents itself as the main topic of this article.

Throughout the remainder of this article, the shorter "liberal" will be used for "classical liberal or libertarian," partly because this

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[2]In addition to Simons, other noted anti-corporation liberals from the previous century include Wilhelm Röpke (1963) and Walter Eucken (1951, 1952). More recent critiques of the corporation from an Austrian point of view include Piet-Hein van Eeghen (1997, pp. 85–113) and Jeff Barr and Lee Iglody (2001). Interestingly, the FAQ of the Libertarian Party also proposes to "abolish the limited-liability shield laws to make corporate officers and stockholders fully responsible for a corporation's actions," but seemingly without advocating an all-out repeal of the private right to free incorporation (www.cath.org/~esr/faqs/libertarianism/html).

article is, perhaps, more classical liberal than modern libertarian in flavor, in that it insists on a legitimate and important, be it strictly limited, role for government—a position which is obviously not shared by all modern libertarians.

However, modern libertarianism seems not only characterized by its views on the role or nonrole of government, but also by a certain methodology, which this article fully shares and which has two main elements. First, modern libertarians are inclined to argue rigorously from abstract first principles, such as the right to self-ownership, the principle of nonaggression or the principle of personal responsibility, which are considered to be grounded in natural law (there may, of course, be disagreement about the exact formulation and foundation of these first principles, which is not unproblematic nor uncontroversial). Second, they are committed to showing that their deductions from such first principles produce universally beneficial and workable policy prescriptions. Hence, the rightness of such prescriptions is both deontological (based on the validity of the natural law from which they are derived) and consequentialist (based on the demonstrable beneficiality of their practical outworking). Put more simply, libertarians seek to be both principled and practical. While some noted libertarians (like David Friedman) seem to have given up on the principledness of libertarianism and other prominent libertarians (like Walter Block) do not always appear to face up to the negative practical consequences of some of what are currently considered standard libertarian policy proposals (more later in this article), the need for both a deontological-principled and a consequentialist-practical grounding of libertarian policy proposals remains imperative, even if far from all logical and practical problems attached to such a dual grounding have been solved as yet.

This article, which is divided into two parts, is organized as follows. Part I is in front of the reader, while Part II will appear in the next issue of this journal. Part I starts with a discussion of the distinguishing features of the corporate form, because disagreement over the legitimacy of the corporation often stems from disagreement over its fundamental nature. It subsequently advocates the idea that free incorporation of private business concerns violates basic liberal principles. After having discussed in some detail the various negative consequences of corporate dominance over capitalist practice, Part I ends with a brief reaction to Block's critique of Simons.

Part II has two main objectives, the first to present a challenge to Robert Hessen's *In Defense of the Corporation* (1974), which remains (perhaps together with Easterbrook and Fischel's [1991; 1985, pp. 89–117] various writings on the topic) the most detailed and careful defense of the corporation from a liberal point of view to date. Given

that we do not wish to advocate an outright ban on the incorporation of all private concerns, the second objective of Part II is to investigate the criteria according to which government may still grant corporate status to private institutions. Roughly, our proposal is to go back to the historical (roughly pre-1860) practice of allowing incorporation only on the grounds that the private concern performs some state-like function or pursues a public interest within a limited public domain; in line with the classical liberal tradition, we assume that such a domain exists in which state intervention is justified. What all this boils down to is that the corporate form should be restricted to private firms involved in the construction and ownership of infrastructural works (like roads, railways, canals, and mining infrastructure), which is also in material agreement with historical practice.

THE NATURE OF THE CORPORATION

Before the corporation can be criticized, its precise nature must first be established. While it is common to list various typical corporate features, such as entity status, limited liability and perpetuity, there is really only one defining feature: entity status. Entity status means that certain legal rights and duties are held by the corporation as a separate, impersonal legal entity. In the case of the private business corporation, entity status implies that title to the firm's assets is held by the corporation in its own right, separate from its shareholders.

Illustrative of the fact that the corporate form of private enterprise deviates from traditional forms of private property, entity status renders the legal position of both corporate shareholders and managers (directors) awkward and ambiguous. As for corporate shareholders, they are commonly regarded as the owners of the corporation, but they are owners only in a limited sense. Shareholders do not have title to the assets of the corporate firm, but merely possess the right to appoint management and to receive dividends as and when these are declared; title to the firm's assets reverts back to shareholders only when its corporate status is terminated. The lack of ownership rights over assets is illustrated by the fact that, in contrast to partners in an unincorporated partnership, corporate shareholders cannot lay claim to their share of the assets of the corporate firm nor do they have the right to force their co-partners to buy them out. Corporate shareholders can liquidate their investment only by selling their shares to third parties. In short, the ambiguity in the legal position of shareholders lies in the fact that, while certain traditional ownership rights rest with them (profit accrual and power to appoint agents to manage the firm for them), other traditional ownership rights are exercised by the corporation as a legal entity separate from them (title to the firm's assets).

As for corporate management, their legal position is equally ambiguous. Managers are appointed by directors who are the representatives of shareholders. Ultimately, management is thus the agent for shareholders, managing the corporation as their representative. This, however, is only part of the picture. While management is the agent for shareholders in the sense of being ultimately appointed by and accountable to them, it is also the agent for the corporation itself. After all, in order to manage the corporation's assets, management must legally represent the corporation as the titleholder to these assets. And because the corporation is an impersonal legal entity, agency for the corporation lends a significant degree of autonomy to the position of management, which is precisely why it has proved so difficult to make shareholder control over management more effective, despite the many legislative measures aimed at enhancing management accountability to shareholders. The significant degree of autonomy inherent in the legal position of corporate management was, of course, the main theme of Berle and Means's (1932) seminal work on the corporation. To sum up, the position of management is ambiguous because management acts as agent for two principals, the shareholders and the corporation.[3]

Other typical features of the corporation like limited liability and perpetuity are not independent, original attributes, but are derived from its entity status.

Shareholders possess limited liability because they do not own the corporation's assets and are, consequently, also not liable for claims against these assets. Responsibility for corporate debt rests with the corporation in its own right rather than with them. Corporate creditors cannot, therefore, lay claim to the personal possessions of corporate shareholders, as they can to the personal possessions of partners in an unincorporated partnership. The most shareholders can lose is their initial investment when buying the shares, which happens only when the corporation goes bankrupt and the shares lose their value. Such is the origin of limited liability for shareholders.

The corporate feature of perpetuity can also be traced back to the corporation's entity status. It is because assets are owned by the corporation in its own right rather than by shareholders that the death or departure of shareholders does not affect its continued existence. While unincorporated partnerships need to be legally reconstituted

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[3]The fact that principal-agent models of corporate behavior treat management as merely the agent for shareholders, ignoring its agency for the corporation, seems to an important degree responsible for the low descriptive value of such models. On that topic, see Mueller (1992, pp. 157–59).

each time partners leave, die, or are added, corporations continue irrespective of who holds their shares. The corporation's entity status thus gives it a life independent of the life of its shareholders, which is the sense in which it is commonly said to possess perpetuity or immortality. This kind of immortality should, of course, not be understood as if corporations literally go on forever, since they can most certainly cease to exist, for example when they go bankrupt or lose their corporate status.

THE CORPORATION: ITS CLASH WITH LIBERAL PRINCIPLES

Originally only state institutions (central, regional, and local government) possessed corporate status, which seems entirely natural and appropriate. If we wish to escape Louis XIV's infamous dictum "l'état c'est moi" ("I am the state"), which is the starkest, most chilling expression of state absolutism from which even ardent monarchists at the time recoiled, the state should indeed be given a legal entity separate from its officials. Only if such a separation exists can state power be vested in the office rather than the person; and only when state power is vested in the office can it be circumscribed by law. All this is the ABC of liberty and the rule of law. But if it is essential to the preservation of liberty and the rule of law that the state has a natural right to corporate status (entity status), it should equally be essential to the preservation of liberty and the rule of law that private individuals, when pursuing their own interests, are denied such a right and act in their personal capacity, which obviously does not exclude the possibility of private individuals acting as agents for each other.[4]

[4]There is no space here to elaborate on the origin and rationale for the corporate nature of the state, about which the political theory literature, both classical and contemporary, is surprisingly mute in spite of it being universally taken for granted in actual constitutional practice. Suffice it to say that the state has to be supra-personal, precisely because its task is to defend personal rights. Its powers to effect such protection cannot rest with the sovereign as a person, as that would give him or her absolute powers over the very private citizens he or she is to protect (the weakness in Hobbes's argument). Neither does it seem logical to suggest that state powers can be derived from the sovereign rights of individual citizens themselves, because these rights are then presumed already protected prior to the state being instituted, which undermines the very rationale for setting up a state by social contract and begs the question as to how citizens can effectively assert unprotected rights to establish such a contract (the weakness in Locke's argument as well as that of the anarcho-capitalists). If state powers are thus not derivable from the sovereign rights of either citizens or state officials in their personal capacity, they have to be understood as belonging to the state

Given that entity status naturally belongs to the state, it should come as no surprise that "at its origin . . . the [private business] corporation was conceived as an agency of the government, endowed with public attributes, exclusive privileges, and political power, and designed to serve a social function for the state" (Handlin 1945, p. 22).[5] Thus the historical practice developed that the state (Crown and, later, parliament) conferred corporate status on certain private institutions on the grounds that these institutions served some area of common interest or performed some function closely related to those classically belonging to the state, for the execution of which certain privileges (like legally protected monopoly rights) were frequently granted as well. Noted early examples of private business firms thus chartered include the medieval guilds, the Dutch and English colonial trading companies of the seventeenth century, as well as the Dutch and English forerunners of modern central banks (the Bank of Amsterdam and the Bank of England) of roughly the same era.[6]

Indeed, the corporate form was abused from the outset for the pursuit of purely private business interests. In some instances this abuse resulted from the fact that the presumed common interest on the basis of which incorporation was granted, turned out to be a sectional private interest, which was particularly pernicious when certain monopoly privileges were included in the charter too.[7] In other

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as a legal entity separate from citizens and office bearers. The implication is that natural law should regard state powers and individual rights as co-dependent as well as equally original and foundational. The one should not be treated as prior to the other. What this means, among other things, is that fundamental liberal principles like the principle of nonaggression or the principle of personal responsibility should simultaneously define the rights and powers of both citizens and the state.

[5]For further insightful discussions of the historical origins and development of the corporation, see, John P. Davis (1961); Joseph S. Davis (1965); Dodd (1934); Cooke (1950); Hartz (1968); du Bois (1971); Creighton (1990).

[6]Not insignificantly, these latter institutions are precisely where the rot in the monetary system set in, as many liberals would undoubtedly agree.

[7]The case of the colonial trading companies is more complicated. Their incorporation seems to have been warranted on the grounds that they had to perform state-like functions (like defense and law enforcement) in their colonial territories. But it was also unwarranted as their prime aim was clearly the monetary interest of their shareholders. Some formula should have been found according to which an incorporated state body performed the governmental functions in the colonies (funded by the mother country or the colonials themselves), while trading activities themselves remained unincorporated. As the relevant colonies developed and prospered, they started to resemble such a situation more closely anyway.

instances the abuse stemmed from the fact that, in the course of the seventeenth and eighteenth centuries, the state increasingly condoned the practice of corporations getting involved in activities outside of the common interest to which their charter originally restricted them. In still other instances, unincorporated firms simply assumed corporate status without any state permission at all. Generally speaking, in the course of the seventeenth and eighteenth centuries governments became increasingly lax in controlling private corporations to ensure that their privileged status was confined to the public domain (to be discussed in Part II) and used to further the public interest.

To restore order in this chaotic situation Western governments had only two policy options. Either they could go back to the original policy of allowing private incorporation only when the incorporated institution performed state-like functions and was deemed to serve some area of common interest within the public domain—and more strictly enforce such a policy. Or they could allow private people to freely incorporate themselves at their own discretion without any restrictions but also without any (monopoly) privileges. After some decades of indecision, most Western governments opted for complete freedom of private incorporation (they passed so-called generalized incorporation laws), which happened around the second half of the nineteenth century. From then on, the corporation became the preferred legal form of the private business firm and soon came to dominate the capitalist landscape—as it has done ever since.

Free incorporation for private business is objectionable from a liberal point of view because it grants a distinctive feature of the public sector, namely entity status, to private concerns without the accompanying restraints of democratic and legal control. As such, the private corporation constitutes an illegitimate mixing of the legitimate domains of the private and public sectors. If it is agreed that entity status is indeed a typical attribute of the state, then anarcho-capitalists who advocate a stateless society have even more reason to oppose private firms taking on state-like attributes such as happens when they acquire corporate status.

Two further, closely related ways in which free incorporation for private business violates basic liberal values can be mentioned, about which we can be more brief.

First, the private right to free incorporation conflicts with the individualism inherent in liberalism, because private ownership rights are given to impersonal entities. The Harvard legal historian Morton Horwitz (1987, p. 21) notes in this connection:

> The corporation . . . was the most powerful and prominent example of the emergence of non-individualistic or, if you will, collectivist

> legal institutions. . . . In all Western countries . . . theories of corporate personality were associated with a crisis of legitimacy in liberal individualism.

Have modern liberals ever squarely faced up to this "crisis of legitimacy"?

Second, free private incorporation contravenes the basic liberal (and common law) principle of personal responsibility. According to this principle, people should not only be granted the freedom to make their own decisions, but they should also carry the full positive and negative consequences of these decisions. Otherwise, rights get given without the accompanying responsibilities, which inevitably has the effect of stimulating irresponsible behavior. As the moralists of old used to say: "liberty without responsibility is licence." The British historian Arthur Bryant (1940, p. 247) similarly notes:

> The historic justification of private property has been that it fostered responsibility and acted as a bulwark against tyranny. It was now [i.e., after the British parliament passed generalized incorporation laws in 1862] being used by the individual to purchase freedom from responsibility.

Andrew Fraser (1998, p. 129) more recently remarks in this vein: "Corporate law has been designed to facilitate a legalized flight from responsibility by those who nominally own the corporate system."

Corporate shareholdership is a licentious and irresponsible form of ownership because it is granted privileges of ownership (accrual of profits and the appointment of agent-managers) without carrying the obligations of ownership (payment for losses). If shareholders receive the full benefit of enterprise when things go well, why should they not also carry the full cost of enterprise when things turn awry?[8] Similarly, corporate management is licentious because it enjoys the privileges of ownership (control over assets by virtue of being the agent for the corporation) without having to face the burdens of ownership (payment for acquisition or loss bearing) and without being accountable to natural persons who do carry the full extent of these burdens, as shareholders don't do either. As already mentioned, insofar as management is accountable to shareholders, such accountability is difficult to make effective especially when shareholdership has become highly diluted.

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[8]The objection can be raised that bankruptcy law already limits the liability of ownership in this way. Unfortunately, the issue of how a liberal order based on the principle of personal responsibility should treat bankruptcy law is too involved to be treated here, with the result that an answer to this objection has to remain outstanding.

When Berle and Means broached this subject they were not saying anything new, but were merely rehashing an old theme in fresh ways. The inherent lack of responsibility on the part of corporate management was lamented by all the pillars of classical and neoclassical economics. Smith, Ricardo, Mill, McCullough, and Marshall were all wary of the corporation being liable to mismanagement because of the inherent difficulty of making management's accountability to shareholders effective and who, as a result, found the private corporation an aberration of private property and potentially dangerous to the liberal order they stood for.[9]

Classical writers, especially Smith (1976, pp. 723–58), thought that this mismanagement would primarily take the form of inefficiency and unproductivity, about which he was glaringly wrong—corporations have proven to be extraordinarily efficient and productive. But management's proneness to irresponsibility may take many different forms, on which we will elaborate in the next section.

The above should obviously not be taken to mean that the moral character of corporate managers is somehow on average more deficient. The point is not that managers as persons are necessarily irresponsible but only that their legal position is inherently lacking in responsibility and as such prone to abuse. The fact that the relevant temptations are often resisted and that many corporate firms are indeed decent and law abiding institutions with a sincere sense of moral obligation to both shareholders and the wider public bears witness to the decency of many corporate managers. As Alfred Marshall (1920, p. 253) already had to admit:

> It is a strong proof of the marvelous growth in recent times of a spirit of honesty and uprightness in commercial matters, that the leading officers of great public companies yield as little as they do to the vast temptations to fraud which lie in their way.

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[9]For a brief overview of classical thought on the corporation, see Mueller (1992). It could be argued that the classicals' negative attitude toward the corporation is not necessarily applicable to the modern corporation, because the corporation of their time was something different from its modern counterpart being indeed a creation of the state whereas the modern corporation is not. But a corporation is a corporation because it has certain legal attributes (entity status in particular), not because it has acquired these attributes in a certain way, as a state concession or by private contracting. And because these corporate attributes are the same then as they are today, we are allowed to apply the classicals' negative comments on the corporation (which they ascribed to these attributes) to the modern corporation as well. Even so, as will be argued in Part II, private agents should not have the right to freely create their own corporate entities without express state permission.

From a current perspective, however, Marshall's observations need to be qualified in two important ways. First, the "spirit of honesty and uprightness" among corporate management is probably less prevalent now than it used to be during the nineteenth century when the remains of a gentler and more chivalrous age were perhaps still more in evidence; the market seems in the meantime to have become a considerably harsher place where gain is more uncompromisingly pursued. Second, without necessarily yielding to dishonesty or fraud, corporate managers will unavoidably display behavioral tendencies which have undesirable long-run effects for society, as will be investigated more closely in the next section.

THE CORPORATION: ITS NEGATIVE CONSEQUENCES

Nobody denies the tremendous productivity advantages of the corporate form of the private business firm, for which there are two closely interrelated reasons.

First, the capital base of the corporate firm is potentially much larger than that of the unincorporated partnership. Because a partner in a partnership carries personal responsibility for the assets and debts of the firm, there will be a stronger incentive for such a person to be intimately involved in its management so as to ensure that risks remain within proper limits; absentee ownership of unincorporated partnerships is just too hazardous. Given that a firm can only be effectively managed by a limited number of fully liable owner-managers, the capital base of partnerships will thus be limited to what that limited number of partners can contribute. The corporation is free from such limitations to the number of capital-contributing shareholders, because shareholders enjoy limited liability and need not be involved in the running of the firm at all. Moreover, given that partners in an unincorporated partnership have a shared legal right to its assets, they also have the right to force their co-partners to buy them out. As a result, the larger the capital contribution of each partner, the greater the potential strain on co-partners to find the necessary capital to buy each other out, should one or more of them die or wish to leave, which is a further way in which the capital base of unincorporated partnerships is naturally limited.[10] By contrast, because title to its assets rests with the corporation in its own right (the corporation enjoys entity status), corporate shareholders have

[10]The threat posed to the continued existence of a partnership by the right of each partner to dissolve it and force co-partners to buy him or her out partly explains why partnerships tended to survive best in a family context where family loyalty reinforces loyalty toward the partnership.

no legal right to force their fellow-shareholders to buy them out, with the result that such limits to its capital base do not apply to the corporation. For these reasons the corporation hardly knows any capital restriction on size whatsoever and is thus able to reap all the economies of scale, and the technological innovations that normally go with them, which were previously out of reach of proprietorships and partnerships.[11]

Second, limited liability provides a measure of systematic risk protection for shareholders which will enable corporations to take on more risk. This increased ability to carry risk stimulates technological innovation as well as economic activity in general.

Against the productivity advantages of the corporate form stand a number of disadvantages, some of which are more fully elaborated elsewhere (van Eeghen 1997, pp. 96–106).[12] Four of the main ones can be summarized as follows.

(a) Increased Speculative Instability

Because incorporation separates ownership from control, shares in a modern corporation can be traded without necessarily affecting the management nor the capital position of the firm. As a result, an active market in such shares develops more easily. By contrast, the shares in an unincorporated partnership are less marketable because they are more strongly linked to the risks and responsibilities of managing the firm, which old owners are more reluctant give up and new owners accept. Moreover, partners normally have the right to consultation in ownership transfers, which also reduces the marketability of ownership stakes in unincorporated businesses.[13]

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[11]As will be argued in Part II, the corporate form can be maintained for the ownership and development of infrastructural public works, which normally require much more capital than private unincorporated business forms can generally bring together. The advantage of the corporate form's greater capacity to combine large amounts of capital is thus not totally lost to mankind and can still be put to good use.

[12]It is no wonder that modern capitalist practice is so excessively growth oriented, given that the growth-enhancing greater potential for size and risk acceptance of the corporate form are further reinforced by the growth-enhancing greater flexibility of the money stock under a fiat money regime.

[13]Sometimes partners in unincorporated partnerships are denied (or deny themselves) the right to consultation in ownership transfers, which is what underlies the so-called "joint stock principle." The joint stock principle thus facilitates enhanced marketability of shares without necessarily requiring incorporation (incorporation implies joint stock, but not necessarily the other way around). It was mostly the enhanced marketability of shares in

Unfortunately, marketability and the potential for speculative trading are intimately linked. Since incorporation significantly increases the marketability of ownership stakes, it thereby also enhances the opportunities for speculative activity in share markets. In addition, many of the participants in speculative markets are corporations themselves and thus enjoy a degree of risk protection in the form of limited liability. Because the balance between risk and reward is tampered with, speculative activity is artificially stimulated—which is not to say that there is anything inherently wrong with such activity. As Ricardo's disciple, J.R. McCullough, remarked about the passing of generalized incorporation laws by the British Parliament in 1862: "Were Parliament to set about devising means for the encouragement of speculation, over-trading and swindling, what better could it do?" (quoted in Diamond 1982, p. 42). In addition to the instability attributable to a central-bank protected fiat money regime, the excessively speculative nature of modern stock markets adds a further source of unnecessary instability to modern capitalist practice, which has the potential of seriously disrupting the real economy. And the ease and speed with which inordinate amounts of wealth are created and destroyed on the stock exchange is surely not one of the more attractive features of modern capitalist practice.

(b) Increased Market Concentration and Concentration of Control

Because the corporate form increases the average firm size, it will also *ceteris paribus* increase the degree of concentration in any given market. Furthermore, because incorporation enhances the marketability of shares as well as the ease with which capital can be raised, it also creates better opportunities to gain market share by mergers and take-overs. While gaining market share through the stock market by mergers and take-overs is a matter of persuading investors that the combination is more profitable, gaining market share through the goods market is solely a matter of persuading buyers that the quality/price of the product is better than that of competitors. Although the one does not exclude the other and superior profit may be realized through superior price/quality with the interest of investors and goods buyers overlapping, the general buying

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unincorporated joint stock companies which was responsible for the excessive speculative nature of seventeenth and early eighteenth-century stock markets, which gave rise to the Bubble Act in England. It is debatable whether the joint stock principle is not also in conflict with liberal principles. The present author is inclined to think that it is. Inherent in co-ownership of and coresponsibility for the firm seems to be the right to consultation in partnership transfers.

public is ordinarily better protected against market power abuse by sellers when the stock market route to increased market share is virtually blocked, as would be the case when unincorporated business forms are dominant once again.[14] But it should always be remembered that the corporate firm, through its potentially larger capital base, is in a better position to realize scale economies where they exist, which may, on balance, benefit buyers in spite of reduced competition in the relevant goods markets and the greater potential for exploitation by sellers which it entails. Put differently, corporate capitalism does generally make the broad population more prosperous, but it makes shareholders and managers disproportionately more prosperous as well as more powerful, which brings us to a further consideration.[15]

The problem with corporate capitalism is not only one of increased market concentration (at least on the supply side) but also of increased concentration of control. Control has become more concentrated under corporate capitalism for two reasons. First, because of the greater potential for increased firm size already discussed and, second, because of the conglomeration potential. The conglomerate firm, through pyramidal ownership structures, facilitates extensive control with relatively little ownership for the parent firm. Such ownership structures can be ascribed to the ability of firms to own other firms, which is directly attributable to the corporate form. Without incorporation only people can own firms. And because the law, since the abolition of slavery, does not allow people to own people, pyramidal ownership structures become an impossibility. Unincorporated business automatically forbids any form of conglomeration through holding companies. It is significant that prominent liberals like Hayek (1967a) and Hutt (1943), though not necessarily opposed to

[14]The argument that mergers and take-overs are necessary for firms to remain globally competitive is circular, because globalization itself is, to an important degree, the result of the increased potential for size of the corporate form of business.

[15]There is a critical tradition of the corporation, which also originated with Berle and Means, which claims that the corporate form allows management to victimize shareholders. This paper is not concerned with that type of criticism at all. While the corporate form allows management to gain a degree of independence from shareholders which may cause it to further its own interest at the expense of shareholders and thus betray its agency mandate, the corporate form still broadly benefits shareholders as well. Our criticism of the corporate form (corporate dominance over private enterprise due to the private right to free incorporation) is rather concerned with its negative consequences for society at large.

the private right to incorporation, nonetheless wished to control conglomerization by forbidding private corporations to own shares in other corporations, or by denying them voting rights in daughter companies; apparently, they too were concerned about the inherent potential for concentration of control of the corporate form.

The problem with increased concentration of control is that, for a given size of the total economy, fewer people make the relevant decisions: whether and where to invest, what to buy from whom, et cetera. As a result, fewer people are likely to benefit from these decisions, which are also likely to involve larger amounts of money. After all, increased size and concentration of control reduce competition not only on the supply side but on the demand side as well, through the increased buying power of the relevant firm, which particularly affects local labor markets and markets for investment location (of which government is the supplier). Because of the relative mobility of capital, the relative immobility of labor and the scarcity of jobs and tax income in any given locality (especially in Third World settings), the potentially excessive size of corporate firms causes them to obtain a potentially large bargaining advantage over local labor and government, which is why the latter often bend over backward to accommodate corporate investors through tax concessions and low wage policies and why large corporations are often in a position to exercise considerable leverage in their dealings with government.

Generally speaking, corporate capitalist practice has strayed far from the free-enterprise ideal of market decisions being taken at a decentralized level by countless relatively small suppliers and demanders so that market outcomes are broadly impersonal. The very invisibility and beneficence of the invisible hand is thus under threat. No wonder Adam Smith was skeptical about the corporate form of business! A liberal order can never rule out the possibility of market power abuse, but the system should nonetheless provide for circumstances which enable the private sector to rectify its own failures with reasonable likelihood so as to restore sufficient competition. Corporate capitalism seems no longer to provide such circumstances.[16]

[16]There is a sense in which the corporate firm can be said to aid competition. Its potentially larger size creates an increased potential for developing and applying new technologies. In the area of transport and communication, these new technologies stimulate competition by allowing any given market to be reached by an increased number of suppliers, which is precisely how the world has almost become a single market in which everybody competes with just about everybody else (globalization). But in spite of this competition aiding trend, markets have become more rather than less concentrated, mainly

(c) Increased Strength of the Profit Motive

Since corporate shareholders are normally so diversified that they become an amorphous mass, only the lowest common denominator of their wishes can be attended to, which is to maximize return on investment—the wish which the greatest number of shareholders have in common. Put differently, the profit motive is given additional impetus, because it has to perform the additional function of bridging the gap between management and an estranged ownership. The divorce of ownership from control also stimulates the development of a large, impersonal market in corporate control, which makes it even more difficult for management to moderate the pursuit of profit, as they live under the constant threat of losing their position through take-overs—and recall how take-overs are already made easier by the corporate form. That is why corporate behavior tends to be more strongly profit-driven than people tend to be when acting in their private capacity. An exaggerated materialist bias is thus introduced into the liberal capitalist ethos.[17]

(d) Loss of Personal Morality

The simple rule which underlies liberal moral thinking is that the possession of personal responsibility enhances personal morality, because the necessity of having to face the (positive and negative) consequences of one's freely chosen actions and commitments stimulates responsible and thus moral behavior. That is why Hayek (1967b, p. 229) could argue that liberty is a moral education in itself:

> It is . . . an old discovery that morals and moral values will grow only in an environment of freedom, and that, in general, moral standards of people and classes are high only where they have long enjoyed freedom—and proportional to the amount of freedom they have possessed.

And that is why the Christian Right and other conservative free-market groupings in the United States have made a return to an ethic of

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due to an even stronger trend toward consolidation by mergers and take-overs. Most world markets, from beer to banking, are now dominated by just a few very large corporate players. As indicated above, the relative ease with which mergers and take-overs can be effected is also a corporate phenomenon. On balance, therefore, the corporate form is detrimental to the competitiveness of markets.

[17]While the corporate social responsibility movement is not insignificant and has substantially contributed toward important social causes, its scope will always be restricted by the institutional constraints on the ability of corporate management to compromise profit optimization in favor of a shareholdership which is difficult to mobilize *en masse* in support of such compromises.

personal responsibility, by which they mean a sense of personal obligation toward meeting the needs of oneself, one's family and one's broader community, the cornerstone of their political agenda through which they wish to roll back big government and stem the tide of the steady decline in personal moral standards.

But a consistent institutional application of an ethic of personal responsibility surely has to go beyond rolling back state welfare and state regulation (however valid and important that may be) and address the institutionalized irresponsibility of the corporate form of business as well. Due to the impersonal nature of the corporate firm which they represent (the corporate veil), managers have a reduced sense of personal moral agency which inclines them to stray more easily from agreed standards of decency or even break the law. And, as indicated above, the corporate system (the impersonality of the market for corporate ownership stakes) already causes corporate managers to be more narrowly profit-oriented than they would be when acting in their personal capacity, which is bound to diminish corporate concern for moral considerations extending beyond the maximization of profit.[18] Recent corporate scandals add a poignant immediacy to these observations.

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[18]In recent years, concern over the power and moral nihilism of corporations has spread beyond the leftist circles in which it has always been common. Of all recent publications in this mold, the most compelling is David C. Korten's (1995, pp. 9, 13). Korten writes:

> Although this book takes a harshly critical look at the institution of the corporation and the system within which business functions, I have never been, and am not now, antibusiness. . . . The problem is not business or market per se but a badly corrupted global economic system that is gyrating far beyond human control.

Even so, Korten does recommend some measures to counter the power of corporations which could be interpreted as antimarket and antiliberal (pp. 307–24), although, most interestingly, he does recommend a ban on fractional reserve banking for which he credits our very Henry Simons (pp. 185–93, 313).

Another instance of a nonleftist critique of the corporation is Andrew Fraser. Fraser proposes to reform corporate governance by giving a single vote to all shareholders whose investment exceeds a certain minimum but irrespective of how large their investment otherwise is. In that way, he hopes to make space for a new, more civic minded aristocrat-shareholder able to infuse more morality and old-world *noblesse oblige* into corporate practice and prevent it from further "erod[ing] the spiritual foundations of Western civilization" (Fraser 1998, p. 129). Less compelling but also in the pro-capitalist/anticorporation mold is William J. Cook (2000).

If the Christian Right and other conservative free-market groupings were indeed to question the legitimacy of the corporation in the light of their personal responsibility ethic, they might have to pay the price of losing some lavish corporate funding; but it might just make their cause a great deal more consistent and credible, and thus ultimately more powerful.[19]

The core of our critique can now be stated as follows: capitalist practice dominated by the corporate firm has lost a sense of proportion and balance. The corporate form boosts bigness, growth, productivity, financial speculation, inequality, and the pursuit of profit beyond the proper limits set by the liberal principle of personal freedom counterbalanced by personal accountability (that is, being forced, partially by state power, to face the consequences of one's freely chosen actions and commitments). The pursuit of profit is fine but we seem to have become motivated by profit just a bit too much; material prosperity is great but it tends to become just a bit too important for us; harnessing nature's powers and using its resources for our benefit is legitimate but we tend to go a bit overboard with our exploitation of nature; bigness creates marvelous opportunities for productivity gains but corporate firms tend to become somewhat oversized; inequality in income and wealth is the necessary accompaniment of personal freedom and the difference in talent and effort (and luck) which individuals bring to bear on their activities, but the inequalities seem to have become somewhat excessive; speculative activity is proper and may, in fact, be socially beneficial, but the speculative nature of modern financial markets has clearly become excessive, et cetera. If we still have the eyes to see, the threat which these imbalances pose to the long-term survival of free enterprise, if not of democracy and the natural environment, should not be difficult to appreciate.

Consequentialist utilitarianism which pervades modern normative economics will always be able to justify the corporate form by the welfare gains of the considerably greater material productivity of corporate firms as compared to unincorporated proprietorships and partnerships. But liberal policy prescriptions should not only be

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[19]Pat Buchanan is the only exponent of the conservative Christian Right who was prepared to address corporate excesses (during his 1996 presidential campaign) and who did come close to arguing that the corporate form is in breach of an ethic of personal responsibility. This commendable stance was, however, marred by Buchanan's somewhat crude populism (bordering on jingoism) and his general political unsophistication (see Derber 1977, pp. 172–74). While Derber (1977) criticizes the corporation from a more leftist (pro-government, anti-free-market) vantage point than the present author is comfortable with, his book still contains valuable insights.

judged by their estimated effect on social welfare insofar as measurable (consequentiality), but also by the inherent rightness of individual liberty and responsibility (deontology). As stated in the previous paragraph, the pursuit of profit and material advancement is fine within the limits of what personal liberty and responsibility allow, but not beyond that. And if social welfare is permitted to record more than just the gains from the greater abundance of goods and the negative side effects of that greater abundance are honestly considered as well, then the impact of free incorporation on social welfare may just be negative on balance, although the inevitable difficulties in measuring the relevant welfare gains and losses, even roughly, will always make it hard to prove this objectively.

A CRITIQUE OF BLOCK'S CRITIQUE OF SIMONS

The negative consequences of free incorporation discussed in the previous section overlap to an important degree with Henry Simons's (1948) concerns about corporate capitalism's unduly skewed income and wealth distribution and its proneness to monopoly abuse, which he regularly sought to counteract through state regulation or the legal strengthening of labor unions.[20] Without having to go into much detail, the essence of Block's (2002) critique of Simons can be summarized as follows. First, Block points out that government intervention and the legal bolstering of union power are illiberal measures with seriously destructive side effects. Second, he emphasizes that there is nothing necessarily and inherently wrong with market concentration (which can be gained by offering a superior price/quality combination), inequalities of income and wealth (which can be due to difference in skill, effort and good fortune), financial speculation (which is the corollary of free exchange) or the profit motive (which merely expresses free agents' primary responsibility to provide for their own needs). Because these arguments are fairly standard in liberal circles, most liberals would find it easy to agree with Block on this score.

[20]Stigler (1983, p. 1) notes in a warm-hearted biographical sketch of Simons, how "[t]his strong egalitarian element separated Simons from most conservatives." While a strict egalitarianism is most certainly incompatible with liberalism, a liberal may still legitimately inquire whether current inequalities are not excessive and even unjustified, namely insofar as the result of a systematic, institutional bias in favor of certain categories in society. Because the corporate form raises the power and profitability of business ownership, it creates an institutional bias in favor of those with a major stake in the corporate business sector (shareholders and managers) at the expense of those who do not.

But the fact that there is nothing necessarily and inherently wrong with monopoly, inequality, speculation, and the pursuit of profit does not justify them being artificially boosted by the corporate form. Not recognizing this possibility is where Block misses the mark and becomes unfair to Simons. Surely, if it is improper, as Block is at pains to point out, to use the law to elevate the power of unions beyond what they can naturally obtain by the freedom of (dis)association, then it should also be improper to elevate the power of private business firms in the same way. And the fact that Bill Gates most certainly deserves to earn incomparably more than almost all of us, does not negate the possibility that the relevant income differences are somewhat excessive. A return to a situation where private business concerns are once again mostly organized by way of proprietorships or partnerships, while not designed to eradicate income differences in any way, should at least be able to bring back some semblance of proportionality to free-market earnings.[21]

In conclusion, the main problem with Block's critique of Simons is that it shuts the door on the liberating realization that capitalism and corporate capitalism need not be synonymous. That realization is liberating for a number of related reasons. First, it relieves liberals from a strained sense of obligation to defend some clearly objectionable aspects of corporate capitalist practice out of loyalty to liberal principles. Second, it enables them to be more openminded about leftist critiques of that practice without feeling obliged to endorse leftist alternatives. Third, it strengthens the conviction that a more consistent application of liberal principles is far better able to address the ills of modern capitalist practice than any socialist, liberty-destroying alternative could ever do. Last, it helps liberalism to transcend the conventional political divide between a rightist/pro-business/pro-free-market orientation and a leftist/pro-interventionist ("liberal" in the American sense of the term) orientation, which keeps public opinion in the grip of an insoluble policy dilemma. Conservative rightists are legitimately concerned about personal freedom and private property, which they, however, wrongly express by providing legal protection for the private corporate firm. In turn, leftists are legitimately concerned about the negative side-effects of a

[21]The liberal case for diminishing the power of unions by removing their preferential legal treatment would be much enhanced if the power of business were simultaneously diminished by removing their preferential legal treatment in the form of free incorporation. If the power of big business were curtailed, there would be no need for countervailing powers in the form of either big labor or big government.

marketplace dominated by big corporations, which they, however, wrongly express by seeking refuge in state intervention. If liberalism were to combine its pro-free-market stance with a rejection of the private right to free incorporation, it could show respect for the legitimate concerns of both sides, thus opening up a much larger audience for its ideas.

All this will probably not impress Block, because he is not convinced that the corporation is indeed a state-like institution and that free incorporation is indeed the product of undue state intervention and, as such, in violation of liberal principles. But an in-depth discussion of these issues needs to await Part II of this article.

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GOVERNMENTAL INEVITABILITY: REPLY TO HOLCOMBE

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RANDY HOLCOMBE'S "GOVERNMENT: UNNECESSARY but Inevitable" (2004) is an interesting and challenging, but ultimately fallacious, essay on government. In his view, this institution is "unnecessary, but inevitable."

I heartily agree with the former contention, but adamantly reject the latter. Worse is the implication for him of the supposed inevitability of the state: Since it will come about in any case, we men of good will should strive to set one up ourselves in cases where this has not yet come about, so that our version of it may serve to stave off a later and more virulent strain of it.

Holcombe (2004, p. 326) writes: "If people create their own government preemptively, they can design a government that may be less predatory than the one that outside aggressors otherwise would impose on them." This is akin to the cowpox smallpox technique. Infect the patient with the former, which is a mild strain, so that his white blood cells can create antibodies to fight it off; then, when the stronger smallpox attacks, the defenses would already be set up and strengthened, able to fight off the disease. (thedorsetpage 2000).

In order to test this hypothesis, let us apply it not to any one nation, but to the possibility of world government. Hans-Hermann Hoppe (2004) speaks of this institution as follows:

> Imagine a world government, democratically elected according to the principle of one-man-one-vote on a worldwide scale. What would the probable outcome of an election be? Most likely, we would get a Chinese-Indian coalition government. And what would this government most likely decide to do in order to satisfy its supporters and be reelected? The government would probably

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> find that the so-called Western world had far too much wealth and the rest of the world, in particular China and India, had far too little, and hence, that a systematic wealth and income redistribution would be called for.

According to Holcombe's hypothesis, we should forthwith, without hesitation, immediately create a world government? Why? Because if we do not, people worse than ourselves will eventually do so, and then we will be forced to suffer under their rule. Strictly, speaking, of course, world government is unnecessary. Private defense agencies and/or individual nations are perfectly capable of providing all the defense services and "public goods" any of us require, or ever will require. But a world government is *inevitable*. That being the case, better that we install one of our own as soon as possible, than that *they*, the evil ones, do so.

When put in these terms, the "logic" of the argument is plain to see. First of all, we have survived all these many years, nay, centuries, without the benefits of any world government. It is difficult to see that it is "inevitable." Second, even if it is unavoidable, *arguendo*, we are still required, as moral agents, to oppose this evil institution to our utmost. After all, no man is perfect. We all have flaws. In this sense, imperfection, too, is "inevitable." Does this mean we are somehow off the hook if we fail to ethically improve ourselves? Of course not. The only proper course of action is to strive mightily against the evil in our own hearts, no matter that we are predestined never to fully eradicate it. Holcombe is saying, in effect, "If rape is inevitable, relax and enjoy it." I am saying, "Even if rape is inevitable, keep fighting against this injustice."

Then, too, "inevitability" springs only awkwardly from the pen of an economist such as Holcombe, for all such claims run head on into the primordial fact of free will.[1] If people can make choices—and they can—then nothing concerning human institutions can be "inevitable." To attempt to deny free will is, of necessity, to engage in it. When something cannot be denied apart from pain of self-contradiction, we can interpret it as necessarily occurring. Thus, *government* is not inevitable; only free will is. And, with the latter, the inevitable status of the state cannot logically be entertained, let alone insisted upon, as per Holcombe.

On the contrary, whether the state remains with us will stem from decisions people make; they are just as free to keep a government in their repertoire as to reject it.

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[1]See Mises (1978).

INSURANCE

Holcombe claims he sees the government as unnecessary in that private institutions can readily take over its provision of defense. However, he does not fully subscribe to this correct notion. I say that because Holcombe criticizes one of the leading authorities on this issue, Hans-Hermann Hoppe (1998/99), who claims that insurance firms can provide defense services. Holcombe (2004, p. 327, n. 8), condemns Hoppe's argument on the following ground:

> In the absence of government, if companies offered insurance against losses from foreign invasion, they might find it cheaper to pay their policyholders for their losses than to provide defense services to protect them.

But this analysis must be rejected at the outset. If the foreign invaders take over, it is likely, according to Holcombe's own reasoning, that they will be *worse* predators than the home-grown variety. If so, the probability is that the intruders will nationalize the entire assets of the domestic insurance industry. Thus, the insurance firm, in the absence of a local government, will be forced willy-nilly into providing not only a promise to indemnify, but also into putting its shoulder to the wheel of defending its clients *and* itself.

GENESIS OF GOVERNMENT

In Holcombe's (2004, p. 328) view:

> The argument that people should do away with government because everything the government does the private sector can do better would be persuasive if governments were created, as their rationales suggest, to improve their subjects' well-being. In fact, governments are not created to improve the public's well-being. In most cases, governments have been imposed on people by force . . . for the purpose of extracting resources from subjects and transferring the control of those resources to those in government.

This, strictly speaking, is a logical fallacy. It implies, nay, boldly states, that "the argument that people should do away with government because everything the government does the private sector can do better" is not persuasive. In my view, however, it is *very* convincing. It cannot be denied, as Holcombe asserts, that governments were created *not* to enhance the general welfare, but rather as an exercise in predation and resource extraction.

But this is beside the point. The reason that government now endures, as opposed to Holcombe's correct explanation concerning its birth, is in large part because of two things. First, it is widely thought that government is inevitable, the very message he himself

is peddling. And, second, because people have been led to believe—"public" education gets the lion's share of the responsibility for spreading this disinformation—that without government, we would be forced to do without necessary and important services, such as armies to defend us from foreign aggressors, police to protect us from local thugs, roads and highways to transport us, hospitals to heal us, schools to educate us, courts to deal with crimes and contract violation, central planners to ward off poverty, etc.

Surely, it is an integral part of the case against statism to demonstrate that *all* of these services (apart from the last) have been provided by the private market, and more effectively so, than by the so-called public sector. In other words, the argument that people should do away with government because everything the government does the private sector can do better is *still* persuasive, even though governments were *certainly not* created, as their rationales suggest, to improve their subjects' well being.

There is yet another difficulty with this statement. Holcombe (2004, p. 328; emphasis added) writes: "In *most* cases, governments have been imposed on people by force." Why "most?" Surely this applies in *all* cases. In fact, I defy Holcombe to mention a single case where this is *not* true.

To compound his error, Holcombe (2004, p. 328) informs us that "Whether government is more-or-less effective in producing public goods or in protecting property is irrelevant." This may well be so for Holcombe, but that is because he is not interested in arguing against statism, but rather in supporting (a "good" version of) it. This does not mean that I interpret Holcombe to be a statist who loves government for government's sake. But he does *favor* this entity, albeit to ward off something he and I both consider even worse: a heavily predatory government, as opposed to one that engages in less-intense rights violations.

There is another problem here: what is it with "public goods"? Holcombe is on record as conceding (but calling this "irrelevant") that there is no good or service uniquely "governmental" in that private enterprise, at some place or time or other, has also provided it. But the phrase "public good" implies a *denial* of this contention; it is based on the claim that there are some things only government, not the market, can provide.

IMPLICATION?

In Holcombe's (2004, p. 328; emphasis added) view:

> Governments were created by force to rule over people and extract resources from them. *Thus* the argument that citizens would be

> better off if they replaced government activities with private arrangements and market transactions is irrelevant to the issue of whether an orderly anarchy would be a desirable—or even feasible—replacement for government.

But the "thus" is a logical howler. It does not at all logically follow that because government was born in predation, not welfare enhancement, the efficacy of markets *vis-à-vis* government "services" is irrelevant to "whether an orderly anarchy would be a desirable—or even feasible—replacement for government." In order to see this, suppose for a moment the very opposite to be the case. That is, posit that anything the market can do, the government can do better. Would this *weaken* the case for orderly anarchy? To ask this question is to answer it: of *course* such a state of affairs would undermine the argument for a fully free society. In general, is X relevant to Y? Surely it is, if non-X, or lesser X, calls Y into question, or emasculates Y. This is not to deny that Holcombe's (2004, p. 328) question—"whether a group of people with no government can prevent predators both inside and outside their group from using force to establish a government"—is also an important one. It is. But this does not concern the "real issue." *Both* are crucial.

HOBBES

Holcombe (2004, p. 329) calls upon Hobbes's rejection of "anarchy in which nobody prospers because nobody has an incentive to be productive." Roderick Long's (2004) reply is worthy of quotation in full:

> Probably the most famous argument against anarchy is Hobbes. Hobbes' argument is: well, look, human cooperation, social cooperation, requires a structure of law in the background. The reason we can trust each other to cooperate is because we know that there are legal forces that will punish us if we violate each other's rights. I know that they'll punish me if I violate your rights, but they'll also punish you if you violate my rights. And so I can trust you because I don't have to rely on your own personal character. I just have to rely on the fact that you'll be intimidated by the law. So, social cooperation requires this legal framework backed up by force of the state.
>
> Well, Hobbes is assuming several things at once here. First he's assuming that there can't be any social cooperation without law. Second, he's assuming that there can't be any law unless it's enforced by physical force. And third, he's assuming you can't have law enforced by physical force unless it's done by a monopoly state.
>
> But all those assumptions are false. It's certainly true that cooperation can and does emerge, maybe not as efficiently as it would with

> law, but without law. There's Robert Ellickson's book *Order Without Law* where he talks about how neighbors manage to resolve disputes. He offers all these examples about what happens if one farmer's cow wanders onto another farmer's territory and they solve it through some mutual customary agreements and so forth, and there's no legal framework for resolving it. Maybe that's not enough for a complex economy, but it certainly shows that you can have some kind of cooperation without an actual legal framework.
>
> Second, you can have a legal framework that isn't backed up by force. An example would be the Law Merchant in the late Middle Ages: a system of commercial law that was backed up by threats of boycott. Boycott isn't an act of force. But still, you've got merchants making all these contracts, and if you don't abide by the contract, then the court just publicizes to everyone: "this person didn't abide by the contract; take that into account if you're going to make another contract with them."
>
> And third, you can have formal legal systems that do use force that are not monopolistic. Since Hobbes doesn't even consider that possibility, he doesn't really give any argument against it. But you can certainly see examples in history. The history of medieval Iceland, for example, where there was no one center of enforcement. Although there was something that you might perhaps call a government, it had no executive arm at all. It had no police, no soldiers, no nothing. It had a sort of a competitive court system. But then enforcement was just up to whoever. And there were systems that evolved for taking care of that.

MAFIA

Holcombe (2004, p. 329) writes: "The evolution of predatory bandits into mafias (protection firms) and thence into governments may be inevitable."[2]

There are two problems here. First, the equation of a "mafia" with a "protection firm" is not easy to defend. Yes, the Mafia sometimes does good works. In the movie *Godfather I*, Don Corleone refused the baker's request to kill those who raped his daughter, but he authorized a severe beating for these miscreants, an act fully compatible with libertarian punishment theory.[3] But the Mafia in large part is dependent upon governmental victimless crime legislation; without laws against drugs, pornography, prostitution, etc., most of

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[2]For a magnificent illustration of this contention, see Rothbard, "A Fable for Our Times By One of the Unreconstructed."

[3]See Kinsella (1996, pp. 51–74).

its "business" would vanish. In contrast, there is no such phenomenon operating with regard to defense agencies. Further, in the other part of its operations, apart from supplying goods and services rendered illegal by government, the Mafia is an invasive force. It engages in protection rackets, not true protection, e.g., insisting upon payoffs for protection from *itself*. It utilizes fraud, theft, strong-arm tactics, etc.; nothing of the sort is true of the Rothbardian or Hoppean protection agency.[4]

Second, it is by no means true that this process is inevitable. There are vast stretches of the earth's surface where governments have yet to emerge (oceans, Antarctica). As well, if this "evolution" were "inevitable," how does Holcombe account for the lack of a world government? The U.S., at the time of this writing (November 2004) may be interpreted as attempting to play this role. But it is far from established, as its difficulties in overcoming a fifth-rate power like Iraq attest.

Then there is the point that the chaos that many people fear in anarchy can be found even within the bowels of the government. Long (2004) comments on this:

> I think that a lot of people—one reason that they're scared of anarchy is they think that under government it's as though there's some kind of guarantee that's taken away under anarchy. That somehow there's this firm background we can always fall back on that under anarchy is just gone. But the firm background is just the product of people interacting with the incentives that they have. Likewise, when anarchists say people under anarchy would probably have the incentive to do this or that, and people say, "Well, that's not good enough! I don't just want it to be *likely* that they'll have the incentive to do this. I want the government to absolutely guarantee that they'll do it!" But the government is just people. And depending on what the constitutional structure of that government is, it's likely that they'll do this or that. You can't design a constitution that will guarantee that the people in the government will behave in any particular way. You can structure it in such a way so that they're more likely to do this or less likely to do this. And you can see anarchy as just an extension of checks-and-balances to a broader level.

WORLD GOVERNMENT

If it is "inevitable" that the individual, or small group will evolve into a national government, why is it any less certain that the

[4]See Rothbard (1978, 1982) and Hoppe (1998/99, 2001).

national government itself will, in due course, morph into a world government? Consider the "equation" below:

$$\frac{\text{National Government}}{\text{Individual or Small Group}} = \frac{\text{World Government}}{\text{National Government}}$$

The analogy depicted by this "equation" is a very strong one. If, in Holcombe's analysis, the last best hope for small groups or individuals is to install their own relatively benign government, lest others impose on us a far harsher such institution, why does this insight not apply to the 200 or so presently existing countries? Should they not also be led by Holcombe's "invisible hand" to amalgamate into a world government of their own choosing, in order to forestall a less desirable one being imposed upon them by "outsiders?" Yet, at least as of the time of the present writing, there is no evidence whatsoever of any such process taking place.

That consideration does not stop dead all such claims. For example, most economists would buy into the notion that equilibrium is "inevitable," and would not be put off their claim at all by the fact that this state of affairs has never been achieved. But Holcombe, surely, needs more than a *claim* of inevitability in order to make it true. He needs some *reason*, perhaps comparable to what convinces most economists that there is an irresistible force always and ever pushing the economy in the direction of the equilibrium.

In Holcombe's (2004, p. 330) view:

> Firms might prey on their competitors' customers, as competing mafia groups do, to show those customers that their current protective firm is not doing the job and thus to induce them to switch protection firms. This action seems to be a profit-maximizing strategy; hence, protection firms that do not prey on noncustomers may not survive.

When placed in the nonexistent realm of private competing defense agencies, such a claim can only be speculative. Fortunately, we have a reasonable albeit imperfect real-world analogy against which to "test" this hypothesis: the present international situation.[5] Here, national governments take the place of private defense firms.

[5]The similarity between national governments and competing defense agencies is a rather poor one, in that the former necessarily initiates violence while the latter logically cannot—if it does, it is no longer a defense agency. On the former, see Cuzan (1979, pp. 151–58); Hoppe (1993, 2001, 2003); Long (2004); Rothbard (1973; 1978, pp. 191–207; 1998/99, pp. 53–77).

Is it really "profit maximizing" for *countries* to "prey upon their competitors' customers'" national allegiances? Well, let us see. Nazi Germany engaged in precisely that activity, as did the U.S.S.R. It is difficult to reconcile their failure to survive with Holcombe's contention that "firms [e.g., nations] that do not prey on non-customers may not survive."

Long (2004) furnishes yet another piece of the puzzle, in his reply to Holcombe's (and Rand's) objection to anarchism that private defense agencies would prey on their competitors' customers:

> Probably the most popular argument against libertarian anarchy is: well, what happens if (and this is Ayn Rand's famous argument) I think you've violated my rights and you think you haven't, so I call up my protection agency, and you call up your protection agency—why won't they just do battle? What guarantees that they won't do battle? To which, of course, the answer is: well, nothing *guarantees* they won't do battle. Human beings have free will. They can do all kinds of crazy things. They might go to battle. Likewise, George Bush might decide to push the nuclear button tomorrow. They might do all sorts of things.
>
> The question is: what's likely? Which is likelier to settle its disputes through violence: a government or a private protection agency? Well, the difference is that private protection agencies have to bear the costs of their own decisions to go to war. Going to war is expensive. If you have a choice between two protection agencies, and one solves its disputes through violence most of the time, and the other one solves its disputes through arbitration most of the time—now, you might think, "I want the one that solves its disputes through violence—that sounds really cool!" But then you look at your monthly premiums. And you think, well, how committed are you to this Viking mentality? Now, you might be so committed to the Viking mentality that you're willing to pay for it; but still, it is more expensive. A lot of customers are going to say, "I want to go to one that doesn't charge all this extra amount for the violence." Whereas, governments—first of all, they've got captive customers, they can't go anywhere else—but since they're taxing the customers anyway, and so the customers don't have the option to switch to a different agency. And so, governments can externalize the costs of their going to war much more effectively than private agencies can.

NOZICK

Holcombe (2004, p. 330) next opines that

> [t]he problem is even more acute if Nozick is correct in arguing that there is a natural monopoly in the industry. In that case, firms must add to their customer base or lose out to larger firms in the competition.

There are problems here. First, Holcombe reckons in the absence of libertarian critics of Nozick who left little of his philosophical edifice still standing after their intellectual onslaught.[6] Second, we must again wheel in the big guns of (the non-existence of) world government. If this "industry" were truly a "natural monopoly," then surely we would have seen a vibrant world government in existence long before now.[7]

The same consideration serves to blow out of the water Holcombe's (2004, p. 330) use of Tyler Cowen's work (1994, pp. 330): "This tendency toward natural monopoly is accentuated because for protection firms to cooperate in the adjudication of disputes, a single arbitration network is required." If so, there are either stronger countervailing forces, or this phenomenon is not capable on its own of leading to cartelization or monopoly. After all, the world government we would expect on the basis of this consideration has simply *not* arisen, and even the cartels (amalgamations of nations) have been sporadic, temporary, and changing. For example, France was the ally of the U.S. in World War II, but it opposes the present American incursion into Iraq. China was the enemy of the U.S. during the Korean "Police Action" of 1950, but it is now the last best hope of this country for reining in the North Koreans.

PROFIT MAXIMIZATION

Similarly, Holcombe (2004, p. 331) writes that "profit-maximizing firms . . . can be expected to employ (their assets) in the dual roles of protection and predation." Further:

> [P]rotection firms might want to display their excess capacity to use violence conspicuously, in part to reassures their customer and in part to deter aggressors. They also might use these resources, however, in a predatory manner against nonclients.

Who knows? Maybe any or all of this could occur. Perhaps computer firms could prosper by secretly creating viruses and then selling cures for them. Maybe car repair companies could maximize profits by going about in the dead of night dismantling autos, and hoping some of the owners would patronize them; or, better yet, as they repair one aspect of an automobile, purposefully break another,

[6]See the Nozick symposium in the *Journal of Libertarian Studies* (Winter, 1977) including Randy Barnett, Roy A. Childs, Williamson M. Evers, Murray N. Rothbard, and John T. Sanders.

[7]For the argument against "natural monopoly" in economics, see Anderson et al. (2001, pp. 287–302) and Rothbard (1970).

in such a way that the need for fixing the latter will only be discovered later. It is also within the realm of possibility that physicians and pharmaceutical companies would spread disease, and then charge to alleviate their patients of them. Then there are the manufacturers who gain from planned obsolescence. Conceivably, all of these things *could* occur. But this sounds like the superficial criticisms of capitalism offered by socialists and other know-nothings, rather than serious economic analysis.

We are derelict in our duty if we do not ask under which conditions, statism or markets, are these horror scenarios *more likely* to occur. And to ask this question is to answer it. Surely, it is in the realm of *government*, not free enterprise, where this is more probable. As for war, consider the movie *Wag the Dog* for a fictional account of President Clinton's decision to bomb Bosnia in order to deflect attention from himself and his own troubles (newline.com 2001).

CIRCULAR ARGUMENT?

Holcombe (2004, p. 332) claims:

> In the analysis of protection firms, this assumption of voluntary exchange amounts to an assumption the industry's output is already being produced—as a prerequisite for showing that it can be produced by the market! As a simple matter of logic, one cannot assume a conclusion to be true as a condition for showing that it is true. This problem makes the production of protection services a special case from the standpoint of economic analysis.

Are people who argue for ordered anarchy guilty of circular reasoning? Not a bit of it. No more so, leastways, than those who maintain that any other good or service can be supplied by the market.

Take food, for example. I go out on a limb and hereby claim that free enterprise is capable of supplying groceries. Aha, says Holcombe, if he consistently pursues the "logic" of the argument above: "But no farmer would grow much of anything if his property rights were not reasonably secure. And without food, it would be impossible for anyone to supply the defense necessary to plant and harvest in the first place! Neither government *nor* private protection agencies can make their rounds unfed. To assume they are not starving is to argue in a circle."

In this manner, *any* (important enough) good or service (food and defense, as we have seen, but also money, metals, or labor) can be shown not to be economically viable, by private *or* government provision. For none of these things can be supplied in a vacuum. Not a one of them can be offered by anyone unless still other instrumentalities are in place. Money or copper cannot be created by anyone,

private or public, unless there is at least a minimal amount of food, order, etc.

Holcombe is here guilty of the failure to think marginally. This is the source of the famous "diamond-water paradox."[8] Of course, if *all* protection is assumed away, the prospects for food, etc., are dim. In similar manner, without *any* food, no protection can take place. Matters look quite different, however, in the absence of these Herculean assumptions.

Speaking of lapses of logic, compare the following two quotes from Holcombe (2004, p. 331; emphasis added). The first goes as follows:

> [P]rotection firms *might* want to display their excess capacity to use violence conspicuously, in part to reassure their customers and in part to deter aggressors. They also *might* use these resources, however, in a predatory manner against nonclients.

On the next page, Holcome (2004, p. 332; emphasis added) writes:

> [A]s noted in the previous section, using the firm's resources for predatory as well as protective activities *is* a profit-maximizing strategy, and protection firms that are not predatory *will* tend to lose out in the competition with those who are.

Note that Holcombe imperceptibly slides from "might" to "is" and "will" without any intervening argumentation or evidence being put forth. Talk about being convinced by one's own rhetoric. Perhaps this, too, is "inevitable."

Long (2004) offers another brilliant refutation of this particular Holcombe thesis:

> Another popular argument, also used often by the Randians, is that market exchanges presuppose a background of property law. You and I can't be making exchanges of goods for services, or money for services, or whatever, unless there's already a stable background of property law that ensures us the property titles that we have. And because the market, in order to function, presupposes existing

[8]The diamond-water paradox suggests that water, being necessary to human existence, is more important than are diamonds. Yet, diamonds are more expensive than is water, an apparent paradox. The common sense solution to the paradox concerns relative availabilities of diamonds and water, and the uses to which they are put. While we need water to survive, we have a lot of it, and can use it not only for survival but also for such luxuries as washing our cars and watering our lawns. Diamonds are relatively rare, so they are only used in very highly valued ways. Hence, diamonds are more expensive, even though all water is more important. In economic terms, at the margin, water is applied to lower-valued ends.

> background property law, therefore, that property law cannot itself be the product of the market. The property law must emerge—they must really think it must emerge out of an infallible robot or something—but I don't know exactly what it emerges from, but somehow it can't emerge from the market.
>
> But their thinking this is sort of like: first, there's this property law, and it's all put in place, and no market transactions are happening—everyone is just waiting for the whole legal structure to be put in place. And then it's in place—and now we can finally start trading back and forth. It certainly is true that you can't have functioning markets without a functioning legal system; that's true. But it's not as though first the legal system is in place, and then on the last day they finally finish putting the legal system together—then people begin their trading. These things arise together. Legal institutions and economic trade arise together in one and the same place, at one and the same time.

MARKET POWER, COERCION, AND GOVERNMENT

According to Holcombe (2004, p. 333):

> Firms with market power in the protection industry are uniquely in a position to use force to prevent competitors from entering the market or to encourage people to become their customers, simply as a result of the nature of their business. Nozick presents a relatively benign description of how private protective firms might evolve into a minimal state, but in a business where those who are best at using coercion are the most successful, the actual evolution of protection firms into a state may result in a very predatory state.

First of all, there is no such thing as "market power" in proper economics. Yes, for the neoclassicals, this is defined in terms of the number of firms in an industry, and is even "measured" by four-firm or eight-firm concentration ratios or Herfindahl indices.[9] But for all the spurious precision suggested by these statistics, the concept of market power is still highly problematic. It is necessarily arbitrary, as there is no noncontroversial measure of what constitutes the industry itself. How many substitutes are to be included? Does the bread industry comprise white bread, all bread, bread plus rolls and bagels, those plus spaghetti and cereal? Does the defense industry include armed guards, locksmiths, fence makers, judges, the manufacturers of pistols, batons, handcuffs? As there is no precise line that can be drawn around the "industry," all measurements of the "market power" it enjoys are capricious.

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[9]See www.usdoj.gov for a description.

"Power" is entirely a different matter. It depends not on the number of competitors in an "industry," but on the issue of whether competition (free entry) is *allowed* by law. If it is allowed, there is no such thing as market power, even if there is but one seller.[10] If it is not allowed, then there is plenty of power, even with thousands of participants, e.g., the taxi industry in New York City. But this is not *market* power; rather, it is *government* power.

If Holcombe's (2004, p. 333) understanding of "market power" is flawed, this applies, in spades, to a term even more central to his concerns: "coercion." There is simply no such thing as a "business where those who are best at using coercion are the most successful." Gangsters, mafias, thugs, murderers, rapists, and governments utilize coercion, the unjustified use of force. In very sharp contrast indeed, to the extent an entity is purely a *business*, it must of necessity eschew coercion entirely. Rather, if it is in the defense or protection industry, it uses (morally neutral) *force*. It does so only in reaction to, or in defense against, the imminent use of initiatory violence (coercion) against itself or its clients.

The same goes for his understanding of the concept "government." Holcombe (2004, p. 333) offers the following for our consideration: "Every place in the world is ruled by government." However, we have already seen that this is not exactly correct. Apart from the lack of a world government, there are the oceans, and there is Antarctica, where the foul breath of the state hardly exists at all.[11] There is a lack of government, paradoxically, even *within* government.

In this regard, Long (2004) writes:

> The U.S. Constitution says nothing about what happens if different branches of the government disagree about how to resolve things. It doesn't say what happens if the Supreme Court thinks something is unconstitutional but Congress thinks it doesn't, and wants to go ahead and do it anyway. Famously, it doesn't say what happens if there's a dispute between the states and the federal government. The current system where once the Supreme Court declares something unconstitutional, then the Congress and the President don't try to do it anymore (or at least not quite so much)—that didn't always exist. Remember when the Court declared what Andrew Jackson was doing unconstitutional, when he was President, he just said, "Well, they've made their decision, let them enforce it." The Constitution doesn't say whether the way Jackson did it was the right way.

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[10]Think IBM or Alcoa before the advent of competitors.

[11]Ancient Ireland existed in a state of orderly anarchy for centuries. On this, see Peden (1977, pp. 81–96); Friedman (1989); and Miller (1990).

GANGS VS. GOVERNMENTS

In Holcombe's (2004, p. 333, n. 18) view:

> Perhaps the most recent examples of areas effectively without government were Bosnia, Somalia, and Afghanistan in the 1990s, which fell well short of being anarchistic utopias.

But these are *not* cases in point. Here, there most certainly were bands of thugs and warlords on the loose. Are these not governments? Anyone who denies this must show a relevant difference between these marauders and the *governments* of such worthies as Stalin, Hitler, Pol Pot, and their ilk. Yes, to be sure, governments are often distinguished from mere gangs in that the former has some legitimacy lacking in the latter. But it is difficult to see why we need accord any legitimacy at all to the likes of Stalin, Hitler, and Pol Pot.

In any case, whether a group of people is seen as legitimate is not an *essential* definition of government. Rather, the key aspect is whether they engage in initiatory aggression, or coercion. Here, it is clear that the similarities (invasion, predation) between states on the one hand, and robbers, murderers, rapists, thugs, warlords, and gangsters on the other hand, are crucial, while the differences (legitimacy) are not.

Holcombe looks down his nose at Bosnia, Somalia, and Afghanistan, but according to R.J. Rummel (1992, table 1.2), the worldwide total number of noncombatants killed by their own *governments* during twentieth century was 169,200,000, and none of these three even makes the list of contributors.[12] Instead, this carnage was all created by what Holcombe would undoubtedly characterize as "legitimate governments," a contradiction in terms if ever there was one. Statistics on murders in Bosnia, Somalia, and Afghanistan are hard to come by, but it seems unlikely that they would be higher than these grotesque amounts even on a basis proportional to population.

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[12]This is a serious underestimate, since it does not take into account deaths attributable to a variety of government initiatives. For deaths attributed to the U.S. Food and Drug Administration, see Rockwell (1999) and Weinert (1998). For those attributed to socialized medicine, see Barnett and Saliba (2004, pp. 38–56) and Terrell (2003). On fatalities, and road socialism, see Block (1979, pp. 209–38; 1996, pp. 195–207).

For more on the ghastliness of governments, not war lords, see Courtois et al. (1999); Rummel (1992, 1994, 1997); Conquest (1986, 1990).

SECOND BEST

In Holcombe's (2004, pp. 333–34) view:

> [P]eople with no government—or even with a weak government—will find themselves taken over and ruled by predatory gangs who will establish a government over them.

How do we define "weak government?" In any reasonable definition, those of Switzerland, New Zealand, Singapore, Monaco, Liechtenstein, and Iceland must be considered "weak." Yet, they are all doing quite nicely, thank you, at least relative to other such entities one could name.

Hong Kong might be considered as an instance on Holcombe's side of this particular ledger. China, a government more given to predation, did take them over, but it is by no means clear that those with a weak government will find themselves being taken over by a far worse one. In a sense, there is a real question as to which government took over which. Did the tiger eat the mouse, or did the mouse "roar," and reverse the usual outcome? In the Peter Sellers movie *The Mouse that Roared*, a tiny country conquered the mighty U.S. in a war. Ostensibly, Hong Kong is now a small part of China, but the economic system with which Hong Kong has long been associated, capitalism, bodes fair to take over the entire country of China, as the latter slowly throws off its communist shackles.[13]

On another Chinese front, the government of Taiwan would hardly be called "weak." Yet, in comparison with the People's Republic of China, this is not an unreasonable characterization. The implication of Holcombe's analysis is that the latter would have no trouble in "taking over" the former. Yet, at least as of November 2004, this has not happened.

Nor can Iraq's attempt to take over Kuwait be counted as evidence for Holcombe's contention. True, there was the intervention to stop this by an even more powerful robber gang, the U.S., but the point remains that Kuwait, the "weak" government, was *not* taken over by Iraq, the relatively stronger one. As for the U.S., the strongest government in the world seems to be having an inordinate difficulty in taking over Iraq, at best a fifth-rate power. A similar analysis pertains to the U.S. in its early days. In the eighteenth century, it was far "weaker" than the U.K., but the latter proved powerless to prevent the former from leaving its ambit.

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[13]See Gwartney, Lawson, and Block (1996) and Johnson, Holmes, and Kirkpatrick (1999).

PREEMPTIVE STRATEGY

Holcombe (2004, pp. 336–37) offers a strong, even inspiring vision: libertarian ideas can promote freedom. He also concedes that limited government is still thuggish and rights violating. He argues for the latter based on his preemptive strategy: only in this way can we avoid an even worse government.

There is, however, a tension between these two points. First, Holcombe inspires us with liberty and freedom, and the absence of government. Second, he advises us to jettison this ideal, on the ground that if we do not, we will be in for something far worse.

Let us reason by analogy, and see how Holcombe's argument plays out not in the field of government, but, rather, slavery. Accordingly, we now state the following. Slavery is inevitable. Periods of nonslavery are either fleeting, or an illusion. If "we" put ourselves in the hands of relatively kind slave masters, who use softer whips and engage in such nefarious practices with less frequency, we can stave off crueler, harsher slave masters, who will surely enslave us if we, head-in-the-sand ostrich-like, refuse to embrace "nicer" slave masters.

For all I know, there might be some truth, too, in this contention. Slave masters, after all, bear an uncanny resemblance to governments. But as a vision for libertarianism, as something to inspire us, it is difficult to embrace this particular program. Surely, we can do better than this. Holcombe's motto seems to be, "Nice government now, lest worse government later." Our motto, based on the slave analogy, would be "Embrace nice slave masters now, lest harsher ones come along later." What happened to "millions for defense, not a penny for tribute?" This would serve us well not only in rejecting slavery, but also in rejecting government, a slightly different sort of slavery, at bottom.

Holcombe (2004, p. 337) seems to have almost a fetish against "outside predators," but this is unconvincing. The source of the predation is surely irrelevant. Why is he so sure that if "we" set up a government, it will be better than the one imposed on us by "them?" Sometimes, surely, the homegrown version of tyranny is worse than the one imposed upon us by foreigners. Certainly, it would not be a logical contradiction to suppose this to be the case. For example, it was the outsiders, the British, who eradicated the practices of suttee and thuggee in India.[14] The local maharajah governments supported

[14]See sify.com; fact-index.com; and bartleby.com for a discussion of these issues.

these vicious practices. There was virtually one-way immigration traffic on the part of blacks *into* South Africa under its apartheid regime. Surely, this was because the *whites* more humanely ruled the blacks than the latter did for each other. Who can deny that the conquistadores improved matters for the Indian populations of central and South America,[15] who had previously been tearing each other's hearts out and eating them.[16] Stalin murdered so many people in the Soviet Union that it is difficult to see how an outsider, a non-Soviet dictator, could have done any worse. In any case, after living among the locals for decades, even centuries, and tending to intermarry with them, the distinction between "our" government and one imposed upon us by "them" tends to disappear.

SCOPE OF LIBERTARIANISM

In Holcombe's (2004, p. 337) view:

> A libertarian analysis of government must go beyond the issue of whether government should exist. Some governments are more libertarian that others, and it is worth studying how government institutions can be designed to minimize their negative impact on liberty.

Yes, yes, of course. No one claims that libertarian theory should be *confined* to the anarchist vs. minarchist issue, and Gwartney et al. (1996) and Johnson et al. (1999) have made some strides in measuring the level of predation of a given government. But this is disingenuous on Holcombe's part. He is doing far more, and worse, than suggesting that there is more to libertarianism than this one issue: He is offering a counsel of despair. Let us give up our hopes for full liberty, for we might worsen our position if we strive for it. As an empirical issue, Holcombe raises interesting points, but as a libertarian analysis, it is sorely wanting. It attacks full freedom merely as a strategy, not as an ideal.

CONCLUSION

Holcombe (2004, p. 337) concludes on the following note:

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[15]At least for those remaining who were not killed by sword or disease. See Diamond (1999).

[16]This is not an argument for paternalistic, imperialistic adventurism. For the libertarian, these forays were unjust even if they had beneficial utilitarian effects. I am only trying to correct Holcombe's bias in favor of home grown tyrants *vis-à-vis* foreign ones. Sometimes, the latter are better.

> History has shown not only that anarchy does not survive, but also that some governments are better than others. Therein lies the libertarian argument for a limited government.

We cannot let this pass without comment. First of all, Holcombe is on record with the claim that government is inevitable. But if this is so, "history" cannot show any such thing. All history can do is record the past. *At best*, history can demonstrate that *so far* we have never had anarchy: We have always suffered under state rule. Consider the analogous claim: "Sunrises are inevitable, and history has shown this to be the case." This, too, is a fallacy. If sunrises are inevitable, then history can show only that *so far* the sun has risen every day, but history cannot demonstrate the *inevitability* of this process. In contrast, it is inevitable that 2 + 2 = 4, that man acts, and that voluntary trade benefits both parties in the *ex ante* sense[17]; that is, it is a logical contradiction to suppose the opposite of these assertions, and they also explain events in the real world. But here, history can only *illustrate* that they are true. It cannot "show" any such thing.

Second, strictly speaking, there is and there can be no "libertarian argument for a limited government."[18] Limited government is simply incompatible with the libertarian nonaggression axiom. In order to more clearly see this, substitute "crime" for "government." This should raise no objection from Holcombe, who concedes that even the best of limited governments are criminal organizations, e.g., "predators." Is this something the true libertarian can accommodate, while still fully adhering to his principles? No, no, no. The libertarian, if he is to be logically consistent, must urge *zero* crime, not a small amount of it. *Any* crime is anathema for the libertarian. *Any* government, no matter how "nice," must therefore also be rejected by the libertarian.

This does not mean that 100 percent of the GDP should be devoted to the eradication of private crime and we all die of starvation. In like manner, the optimal amount of government for the libertarian—whether of the local "nice" variety or the nasty foreign

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[17]See Hoppe (1992), Selgin (1988, pp. 19–58), and Rothbard (1973b, pp. 311–39).

[18]I do not deny that there is such a thing as a limited-government libertarian, or libertarian minarchism. It is in the same vein that I do not deny that if a person takes libertarian positions on all but one issue (say, drugs alone, or abortion alone, or rent control alone), that he can properly be characterized as a libertarian. I would say of all these people that they take libertarian positions on all issues except for the one where they deviate from the nonaggression axiom.

counterpart—is also zero. Similarly, this does not mean it is justified to spend the entire GDP on this quest, or even to engage in it at all (there are pragmatic considerations that apply only in the latter case), but it is the only one fully compatible with libertarianism.

To say that something—government, crime, slavery, it matters not what—is inevitable is to denigrate free will. If *everyone*, without exception, suddenly converted to libertarianism, on that great and glorious day there would be *no* government: nada, zip, none at all. Is it a logical contradiction to suppose such a situation? Of course not. So let us hear no more about the "inevitability" of evil.

Socio-biological considerations lead us to believe not that the criminal government (a redundancy) is inevitable, but, rather, that we are hard wired for institutions of this sort through evolution.[19] Who knows: rule by one man over another might well have had some survival value for our ancient ancestors. But we are also, some of us anyway, genetically inclined to murder, rape, and cheat, as well as to be just, invent new technologies, and love our children.

Holcombe's is a counsel of despair and compromise. Let us, instead, hold aloft our libertarian principles, never compromise with them, and strive, always, for liberty, *full* liberty. At one time in our nation's history, slavery, too, seemed "inevitable." Instead of opting for the softer whips and nicer slave master theory of Holcombe, we should hold out for total and complete freedom.

We can do no better than to end with a quote from Rothbard (1973a, p. 302) in this context:

> Thus, the libertarian abolitionist of slavery, William Lloyd Garrison, was not being "unrealistic" when in the 1830s he first raised the glorious standard of immediate emancipation of the slaves. His goal was the morally proper one, and his strategic realism came in the fact that he did not expect his goal to be quickly reached. We have seen in chapter 1 that Garrison himself distinguished: "Urge immediate abolition as earnestly as we may, it will, alas! be gradual abolition in the end. We have never said that slavery would be overthrown by a single blow; that it ought to be, we shall always contend." Otherwise, as Garrison trenchantly warned, "Gradualism in theory is perpetuity in practice."

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[19]See, e.g., Wilson (1980) and Pinker (1994, 1997, 2002).

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A COMMENT ON COLIN WILLIAMS'S ARGUMENTS AGAINST SPOONER

JAN NARVESON

COLIN WILLIAMS,[1] "CONTRA SPOONER," argues that Lysander Spooner is wrong about the state's being the "instrument of robbery, slavery, and murder." He begins by observing, accurately enough, that Spooner's arguments are constructed of "pure philosophy" and thus require a reply in kind. It is puzzling, then, that Williams thinks to show Spooner wrong by a "survey of the culture of the ancient Mediterranean." This survey produces the result that the ancient Greeks thought nothing of plunder and murdering people as long as they were in some other city. I do not find this defense of plunder and murder particularly compelling.

Further, he argues in reference to the famous argument for government by Hobbes—the paradigm and fountainhead, in a way, of all modern arguments for government. Much can be said about that, but certainly the main thing to say is that it doesn't work. Neither, I think, do any of the numerous arguments concocted by ingenious writers following in Hobbes's footsteps. However, that is beside the present point, for Spooner doesn't really address Hobbes. He much more nearly addresses Locke, arguing that the called-for "consent" on which, according to Locke, government is founded, is not only not forthcoming in the case of America, but essentially impossible in all cases of any significance. On this matter, Spooner is trenchant and extremely incisive. Does Williams have anything substantial to offer against that onslaught?

Williams appeals to the cultural beliefs of the ancient Jews, who thought we made "covenants" with God, of all things—something Hobbes very reasonably argues cannot be meaningfully done. The

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[1]Colin Williams, "Contra Spooner," *Journal of Libertarian Studies* 18, no. 3 (Summer 2004): 1–9.

ancient Jews apparently thought that these covenants were "binding"; to which, surely, any modern writer would reply that it appears that the Jews needed to read Spooner (and, I would add, Hobbes). Again, we should not be impressed.

Williams also cites Aristotle on behalf of the "noncompelling" nature of moral philosophy. We should be slightly more impressed at that, indeed. It would, as Aristotle famously observes, be foolish to expect the same precision in ethics as from geometry. True: but does that militate against having a basic principle that is right? That the principle in question will be "rough," as Aristotle puts it, is one thing. But it's quite another to think it wrong. Aristotle himself held that there was a definition of virtue holding for all cases: observation of a mean with respect to the passions. The mean might be hard to find and imprecise, but that it is the thing to look for and try to go by was, he apparently thought, a philosophical truth—always true. It could likewise be philosophically true that the right rule for people is to respect each other's liberty—even if sometimes it is not entirely easy to say just which actions do so. Thus we are very far from refuting Spooner on this level either.

Williams ends up arguing that obeying the law is one of the "habits of excellence." And why does he say this? One would have hoped that the answer would have consisted in showing the one thing that is absolutely necessary to refute Spooner: namely, that what the government tells us to do is something we really ought to do, something worth doing, and hence something the doing of which, by habit, would constitute a habit of excellence. But Spooner argues that instead the government—any government—is a pack of scoundrels and thieves. Doing what such people tell us to do, just because they tell us to do it, can hardly be a "habit of excellence." So the question is: who is right? Now at this point, I want to suggest that we can divide government rulings into three classes: (a) rulings that work ill on some people in order, perhaps, to do good to some or a lot of others; (b) rulings requiring us to do what we ought to do anyway; (c) rulings that essentially solve Coordination problems, in the sense that they call upon us to do actions such that we need to do one or another of that kind of action, it doesn't matter which we do, but it does matter that we all do the same. Under these circumstances, class (c) would really be virtually a subset of class (b).

I have no doubt whatever that Spooner habitually refrained from murder, cheating, stealing, lying, and in general, inflicting evils on those of his fellow men who inflicted no such evils on others. Such habitual refrainings are indeed habits of excellence. But also, the fact that somebody with a policeman's uniform tells us to do them is entirely beside the point: we ought to do them anyway.

On the other hand, enormous numbers of government rulings are of type (a). Habitually obeying those is arguably not a habit of excellence. But if you're going to go around telling people to Obey the Law, you aren't distinguishing among these classes—important though that distinction is. This being so, the "Aristotelian" appeal as Williams spells it out is either simply question-begging—or, where it isn't, it's just plain wrong. Of course we ought to attend to that distinction, and if we can do so without serious danger to ourselves (and in some cases even then), to refuse to succumb to the imperatives of The Law. It *does* matter.

We should, then, still listen to Spooner.

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BOOK REVIEWS

The Debates of Liberty: An Overview of Individualist Anarchism, 1881–1908. By Wendy McElroy. Lexington, Mass.: Lexington Books, 2002.

THERE WAS A PERIOD in the latter nineteenth century when a distinctively American kind of radicalism flourished, a time when key thinkers could be called, and called themselves, individualists, libertarians, anarchists, and socialists all at once. As individualists and libertarians, they were concerned to achieve a maximum of freedom for each individual. As anarchists, they saw the institution of the state as the principal danger and the principal source of remediable evil in human affairs. As socialists, they shared a labor theory of value and opposition to rent, interest, and monopoly, all of which were conceived as having their roots in state-sponsored and enforced aggression, and shared with other socialists a passion for social reform to bring about a better society. A central figure was Benjamin Tucker who, through his periodical, *Liberty*, helped to make a self-conscious social movement of individuals influenced by thinkers like Josiah Warren, Pierre Proudhon and Lysander Spooner, gave it voice and contributed to shaping it.

It would be far from the truth, however, to suppose that these individualists all managed to agree on the major social and intellectual issues that confronted them. A range of issues, political, cultural, and theoretical, were hotly debated, and *Liberty* provided an outlet and forum in which the debates could be conducted.

Wendy McElroy's book, *The Debates of Liberty: An Overview of Individualist Anarchism, 1881–1908*, begins with a brief chapter, setting the historical context and giving background on Tucker's role and follows with seven more chapters, each following through with the major arguments and positions developed with respect to some issue. The debates explored range over fundamental institutions, questions of political and moral theory, and issues of strategy.

McElroy gives us a window on those debates, and through them, on the people and times involved. But her work is of more than antiquarian interest: their debates and the issues they faced often sound strikingly modern.

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For example, one of the early debates was over the foundational issue of natural rights versus egoism. Many favored the natural-rights doctrine that individuals had certain enforceable rights against others by virtue of their nature. "The substance of these claims is generally stated as a right to the protection of person, property, and peaceful actions" (p. 51). Others, including Benjamin Tucker, and largely as a result of the influence of Max Stirner's *The Ego and His Own*, came to think that natural rights were myths, that the only kind of appeal that made sense was to a person's interests and that the only "right" worth the name was the right that arose through agreement or contract.

Contemporary readers of contractarian political philosophy, especially of a Hobbesian cast, will find much that sounds familiar here. There is the same idea that ultimately reasons must be rooted in what individuals want, that the only kind of constraint on pursuing what they want has to derive from something like a contract, and that it would only be sensible to participate in such an agreement to the extent that it furthered one's prospects for getting what one wants. The *Liberty* debaters also faced the hard problem of what this means for children, and others, not yet able to enter into a contract on equal terms. Interestingly, though evidently without being very comfortable with the position, Tucker and others admitted that their combination of egoism and contractarianism left no place for children but as property. A mother might "throw her baby into the fire as a man throws his newspaper" (p. 78). (Tucker thought he would probably interfere to save the child, but that he would deserve to be punished.)

There are many other debates recounted in the book that will repay consideration, some for the light they throw upon issues and the new (or just forgotten) directions they suggest in contemporary discussions, others for the insight they provide into American intellectual history. On either count, there is much to enjoy and profit from here.

I have only a single minor quibble to raise, which pertains to the organization of the book. Several chapters deal extensively with strategic matters, with questions of the right means for bringing about desirable social and political change. Voting, violence, civil disobedience, and participation in legal institutions are all discussed, but the discussions are not united in the same chapter or even the same sequence of chapters. Substantial discussions can be found in chapters 2, 3, and 7. Similarly, questions having to do with the institutions of an anarchist society, including what will do the job of courts and police, whether intellectual property will be recognized,

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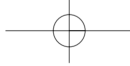
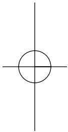
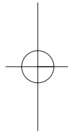


and fundamental issues of money, banking and economics are discussed in chapters 3, 6, and 8. It is not transparent what plan was followed in ordering the chapters. Something in the way of explanation would have been appreciated.

However, this is a minor problem with what is, all in all, a very useful book. In large part, McElroy lets the very eloquent thinkers who debated in the pages of *Liberty* speak for themselves. When she provides explanatory and connecting material her exposition is clear and interesting, while her own commentary is both plainly distinguished from the opinions of her subjects and unobtrusive. McElroy succeeds admirably in what should be the objective for any work of this kind—whetting one's appetite for the original.





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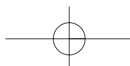

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On Nozick. By Edward Feser. Belmont, Calif: Wadsworth, 2004.

NOZICK'S FLAWLESS LIBERTARIANISM?

THIS BOOK'S MAIN INTENTION is to defend Robert Nozick's *Anarchy, State and Utopia*. Its main conclusion is that there is nothing, or next to nothing, wrong with that work. On the way to this conclusion we are given an excellent, though largely uncritical, introduction to *Anarchy, State and Utopia*. *On Nozick* is also quite a good short (98 pages) introduction to libertarianism as such. It is full of good arguments. I would recommend putting it on any reading list to supplement the study of Nozick's book or to introduce libertarianism. In this review, however, I shall confine myself to critical remarks. My responses are mainly in the order that matters arise in the book.

First, three brief linguistic points. Which proof reader of Wadsworth's allowed "30's" etc. (p. 11 and throughout) without striking out the otiose apostrophe? As an anarchist, I should rather say that liberty ought to be the highest *social* value (or rule) rather than "political value" (p. 11). Feser apparently uses, as do many libertarians, the English word "coercion" to mean not coercion (the use, or threat, of force to constrain or compel some person—possibly in libertarian self-defense or rectification) but to mean any liberty/rights violation even where no coercion is involved (p. 14). He does not do this persistently, though.

In explaining the "impossibility of socialism" Feser does not mention that this is usually known as the economic calculation argument (p. 18). Neither does he quite spell out what the problem is: that the planners have no way of determining the *relative* scarcity of resources. Then, having apparently argued for the "impossibility of socialism," Feser writes of "the socialist economies of the communist world" finally collapsing in the 1980s: "Mises and Hayek predicted, as far back as the 1920's, that this is exactly what would happen" (p. 20). This is a confusion. Mises argued that Marxian socialism is, as Feser earlier noted, *impossible*. There is no known substitute for the price system to determine relative scarcity in an advanced industrial society. Socialism did not collapse after many decades, it was a nonstarter. The USSR had a price system, albeit even more

state-interfered-with than our own, and thus was not socialist in the sense that Mises was criticizing. Of course, there are other senses of socialism and Mises's argument when generalized applies to them as being inefficient to the extent that they override the price system. But they are not what Mises's argument was primarily about. And though Mises's book on socialism was published in 1922, the Hayek-edited *Collectivist Economic Planning: Critical Studies on the Possibilities of Socialism* did not appear until 1935.

Feser objects that "Classical utilitarianism . . . leaves open the possibility that some people may be appropriately sacrificed" (p. 32). This is a logical possibility, but is it a real one? Correctly interpreted, I do not think so. A utilitarian might equally well reply that libertarian rights leave open the possibility that some people may be left to starve. That does not seem to be very likely either. And if observing rights is supposed to accord with "respect for human dignity" then so can promoting human welfare. The practical point is there does not seem to be a real clash between the two. Defenders of rights through most of history would think it strange to attempt to divorce rights from human welfare and then take sides.

We are told that "unless we assume the thesis of self-ownership, we have no way of explaining *why* certain things are wrong that clearly are wrong. The thesis of self-ownership is, then, as plausible and fundamental a moral principle as there could be" (p. 33). It is not much of an *explanation* to insist that the explanation has to stop at the assumption of self-ownership. We can go on to explain how not allowing self-ownership leads to disastrous moral hazards (mentioned by Feser, p. 35) for both liberty (more abstractly defined than just being self-ownership, of course[1]) and welfare. We might even concede that in special extreme cases where self-ownership can harm either liberty or welfare, the case for absolute self-ownership might be morally weakened.[2] Thus we can derive general self-ownership from both liberty[3] and welfare.[4] So self-ownership is not itself "as plausible and fundamental a moral principle as there could be."

It sounds quasi-Marxist and slightly misleading to say that if self-ownership is true "I also own the *products* of my abilities, talents, and labor, that is, whatever wealth I produce in using them" (p. 34). For if I produce something for you under contract, then I need not at

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[1]See Lester (2000, pp. 57–61).

[2]Ibid., pp. 65–66.

[3]Ibid., p. 76.

[4]Ibid., pp. 185–87.

any point own the thing I physically produce or all the wealth it brings. And though I own the money that you pay me for the contractual work, I did not really produce that money and neither did you (unless, perhaps, at least one of us literally produces notes or coins).

Is it true that the "negative" nature of rights means that there is no "danger that they might conflict"? (p. 38). To take only one classic example, what if person A buys all the land surrounding person B and then refuses to allow B to leave B's land? Does A have an "inviolable" right to refuse to allow B to cross his property? Or does B have an "inviolable" right not to be arbitrarily imprisoned? It is such examples that, to my mind, require a libertarian theory of liberty that is anterior to, and more abstract than, both self-ownership and ownership of external property.

I do not know what it means to assert that persons are "free by nature" (p. 39). I certainly think that people ought to be free, in the libertarian sense, and that they are better off being so. I also think this moral principle withstands critical scrutiny. But why are people free "by nature"? Is this supposed to be a moral law that is discovered in nature like a natural law such as gravity? Feser later glosses "natural" as "not derived from or dependent on any human agreements or conventions" (p. 43). But in what way does that make human freedom part of "nature"? I know natural law has a long history, but more needs to be said to make sense of, and defend, it than the few words Feser expends.

Does libertarianism need foundations? Feser considers various possibilities in addition to self-ownership (pp. 48–53). For the critical rationalist, however, the idea that respecting individual liberty is morally desirable remains a conjecture. It is sufficient that there is no known sound reason to interfere with individual liberty (in any systematic or institutional way, at least). Any search for positively justifying this view runs into the epistemological problem that we never know what refuting counterinstance or counterargument we might have overlooked (or even which corroborating examples might convince some people). There is also the problem of an infinite regress if we try to support libertarianism by a more fundamental principle such as enabling humans to pursue "virtue," or "flourish," or be "project pursuers," or have "autonomy." In any case, surely libertarians allow that people have the right to be vicious (if at no one else's imposed expense), to wither, to do nothing much, or be heteronomous. Feser also mentions the idea that the very use of one's body presupposes self-ownership and so one cannot argue against it "without falling into a pragmatic self-contradiction" (p. 50). It seems to be true that in using one's body one presupposes that one has a

right to do so, but only if (as I accept, following Socrates and contradicting Aristotle) it is not possible to do what one genuinely believes to be wrong at the time. But it is not a logical inference that one does have the right just because one must presuppose it in a live argument. If there were a god and he (decided that he) owned us, then he would own us whatever our arguments on the matter.

In the end, Feser concludes that the burden of proof lies with the critics: "It is not *Nozick* who needs to 'provide foundations' for or justify his libertarianism, then—it is his *critics* who need to justify themselves" (p. 54). And the typical welfare statist no doubt shares an equal and opposite view. So we would appear to have a stalemate of each side demanding justification from the other. But no one can provide foundations for their conjectures. When they think they are doing so they are at best explaining how they think their theory will usually apply. It is better to seek (and provide) and address criticism.

Feser sees that protection agencies will "settle disputes between clients by appealing to a neutral third party" (p. 58). But he appears to think that it must be the *same* "third party . . . which numerous firms retain" for all disputes. This is an error (the fallacy of composition). It is sufficient that all protection agencies have bilateral contracts for settling disputes (possibly by some default procedure in the absence of a specifically named third agency; maybe even selecting one by lottery). There is no need for a single agency to arise as the one to which all must ultimately appeal. And any two agencies can change their chosen third party at any time they agree to do so. Thus there is no tendency "toward a kind of natural monopoly . . . a single dominant agency or a single confederation of agencies." And so there is no need for "common arbitration procedures." There can be healthy competition among procedures. Some people might still think that there is a sort of overall monopoly system here. But it is no more a monopoly than exists among banks just because *all* banks have bilateral agreements on how to deal with each other concerning charges, accepting checks, etc. Therefore, there is no reason for a minimal state to emerge by overruling competing agencies that are outside the monopoly.

It is not a "loss of one's full *liberty*" (contra Feser) to become dependent on the state (p. 73). It is, rather, the gain of a licence. It is only a loss of liberty to be forced to pay for this dependence by others.

Nozick argues, and Feser agrees, that taxation is "on a par with forced labor" (pp. 77ff.). Immoral and inefficient though taxation is, it is not on a par with forced labor. It is *only* extortion (and only for those who really pay it; not those who are net tax-consumers, possibly by working for the state). It cannot be on a par with forced labor

for the simple reason that no one is forced to labor. If you sit about doing no work then no one will make you work. Quite the reverse, you will effectively be paid by the welfare state for not working. If you do work—in the private sector, at least—then extortion by the state is difficult to avoid (but you should do your best). Anyway, it would be possible to abolish income tax and replace it with sales tax. Then the retailers alone would be forced to hand over money to the state, and not for working as such (though some work is thereby made necessary). Still less is the so-called welfare state, terrible though it is, a system of "*partial* slavery" (p. 79). There are countries that really do have forced labor and partial slavery. The victims there would rightly see that they are not on a par with those who merely pay income tax. The answer to Nozick's "Tale of a Slave" question (p. 80) is that this is a form of the sorites problem (how many grains of sand make a pile?). Your situation becomes less and less slave-like until it is clearly hyperbole to assert that you are a slave. Otherwise, at a still farther extreme, you would still be a *slave* if only the mildest imposition were to (threaten to) occur only once in your life. You remain, however, a subject—even if you think you are a *free citizen*—of aggressively imposed state rule. And that is bad enough.

Feser tries to muddle through with Nozick's defense of the Lockean labor-mixing (or what-you-own-mixing) theory of initial acquisition. Feser thinks it is "*significantly* to alter a resource or bring it under one's control that effectively turns it into property" (p. 83). Why can I not simply use or rely on some resource (such as a natural water hole, which example Feser later mentions) without significantly altering it or controlling it? What if I significantly alter and control a resource (maybe by damming a small stream in sport) but do not care a jot about it? How *exactly* does significant alteration or control relate to *liberty*? What is the explicit connection? We seem to have, rather, an appeal to a pre-existing vague intuition. If (interpersonal) liberty is more precisely conceived as not being proactively imposed on by other people (to take an example not entirely at random), then it is sufficient that I merely rely on the water hole for me to have some libertarian property claims not to be excluded by someone fencing it off—especially if it is the only water around. Feser later concedes a property claim here (p. 87) but does not square it with the labor-mixing that involves significant alteration or control. If it is true that reliance can be enough, then it is not true that "labor-mixing of some sort seems the only available way of getting property started" (p. 83). And labor-mixed property can sometimes clash with liberty.

He goes further, however, and denies that there can be any injustice in *initial* acquisitions because no one has any libertarian rights

until acquisition takes place. (86) Feser suggests that for A to be the *first* to monopolize a water hole and deny others access would be "callous, cruel and wicked" but not unjust because "it's A's water hole" (p. 87). Why should being there first *always* be trumps as regards *liberty*? A is here being a positive nuisance (or worse, if death by thirst ensues) to other people. He is not protecting the fruits of his labors in any way. So there is no sound analogy between this and merely failing to assist someone by, in Feser's example, not helping him to start his car. The distinction between proactively imposing and merely failing to assist is the crucial abstraction that is required to make sense of the liberty of libertarianism.

In short, I think that Feser does not have adequate arguments to respond to contrary arguments in my own philosophical defense of anarcho-libertarianism as maximising liberty and welfare (despite citing my book in his bibliography). I hope I have not been unfair or unclear in attempting to restate some of my views in response to his defense of Nozick's book. It was largely my perceived inadequacies of *Anarchy, State, and Utopia* that spurred me to write something rather different.

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REFERENCE

Lester, J.C. 2000. *Escape from Leviathan: Liberty, Welfare and Anarchy Reconciled*. Basingstoke, U.K.: Macmillan.