

# A RESPONSE TO BROOKS' SUPPORT OF DEMSETZ ON THE COASE THEOREM

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## Abstract:

Coase (1960) claimed that in the zero costs world, it would not matter for the allocation of resources which of two disputants were awarded the relevant property rights. Block (1977) disputed this, on the ground that it assumed that both parties would have the wherewithal with which to make the relevant bribe. Demsetz (1977) maintained that Block (1977) failed to reckon with Coase's (1960) explicit assumption of no wealth effects. Block (1995) disputed this claim of Demsetz's (1977), claiming the Coase (1960) anticipated no such thing. The next round in this debate was Demsetz (1997) who reiterated his position, followed by Block (2000) in a response to Demsetz (1997). Brook (2007) mostly takes Demsetz's (1977, 1997) side of this ongoing discussion. The present paper is a rejoinder to Brook (2007), supporting Block (1977, 1995, 2000).

**Key words:** Coase, zero costs, positive costs, wealth effects, indifference curves

**JEL category:** K3

## I. Introduction

I am extremely grateful to Brooks (2007) for his commentary on the debate I (Block, 1977, 1995, 2000) had with Demsetz (1979, 1997), which stretched all the way from 1977 to 2000, a span of 23 years. This debate was one of the high points of my intellectual career. I had for a long time wondered whether or not it would interest anyone apart from Demsetz and me. I need not conjecture any longer.

Not only was Brooks (2007) kind enough to enter the lists in this debate, he has made signal contributions to it. He has added to it, and stretched it to directions not contemplated by either of the initial participants in it. In the present paper, however, I shall not follow him into these new arenas. Rather, I shall confine myself<sup>1</sup> to commenting upon his assessment of my and Demsetz's part in it.<sup>2</sup>

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<sup>1</sup> I shall also not comment on Brooks' (2007) and Demsetz's (1979) and my own previous use of indifference curves. One of the things I greatly regret about my previous contributions to this debate is my own utilization of this technique. I shall not repeat this error in this present publication. I regard now, and regarded even then, indifference curves as an illegitimate tool of analysis, in that indifference is not compatible with human action (Mises, 1998). According to Rothbard (1997, 225-226): "... [i]ndifference can never be demonstrated by action. Quite the contrary. Every action necessarily signifies a *choice*, and every choice signifies a definite preference. Action specifically implies the *contrary* of indifference. . . . If a person is really indifferent between two alternatives, then he cannot and will not choose between them.

But, before the specifics, a little background.

As I see matters, Coase (1960) made two major points.<sup>3</sup> In the zero transactions world, if the factory (F) and the gardener (G) are disputing over whether or not the former may pollute the latter, it does not matter which way the court decides the case, at least not for the allocation of resources. That is, whether or not F will be allowed to send off smoke particles into the air which ruins G's property, or F will be forced to cease and desist from this activity, or install a smoke prevention device thus saving the garden, does not depend upon the judicial finding. Rather, it turns on who values the matter under the dispute to the greater degree.

For example, suppose that F places a value of \$100 on being allowed to continue to pollute, and that G assesses the worth of stopping him at \$10. If, under these assumptions, the judge finds in favor of the plaintiff, G, F will bribe G into allowing the pollution in any case.<sup>4</sup> For example, F might pay G \$45 for this privilege. If so, F will gain  $\$100 - \$45 = \$55$ , and G's wealth will increase to  $\$45 - \$10 = \$35$ . "Society," composed entirely of F and G, will gain  $\$55 + \$35 = \$90$  from this deal. Pollution will continue, even though the judge ruled against it. Call this case 1.

On the other hand, suppose the judge rules on the side of F. F still places a value of \$100 on being allowed to continue to pollute; and G, only \$10 on stopping him. Will G be able to bribe F into ceasing and desisting? No. Again the pollution will continue. Call this case 2. Under these circumstances pollution will take place irrespective of the court ruling; what determines the matter is that F values being able to dispose of its wastes into the air more than G disvalues it.

Now for case 3. Here, F places a worth of \$20 on its "right" to pollute, but as G sees it, he loses \$80 if the pollution continues. Again, we start off with a victory for the plaintiff, G. The judge rules that the pollution must stop. Will F be able to offer G sufficient funds so that G will accept the smoke particles entering his garden? No. It is worth only \$20 to do so for G, while G suffers a harm of \$80. So the smoke inundation ceases.

Case 4. The defendant now prevails. The men in black robes give their imprimatur to F; he is permitted to continue his practice. Will G be able to arrange

Indifference is therefore never relevant for action and cannot be demonstrated in action." There is a debate in Austrian circles on indifference. It includes the following: Block, 1980, 2009, unpublished A, unpublished B; Hoppe, 2005, 2009; Hudik, unpublished; Machaj, 2007; Nozick, 1977

<sup>2</sup> See also Block, forthcoming, which covers much the same ground as does the present paper.

<sup>3</sup> I shall limit my commentary in this paper to the positive one. Coase's (1960) second "contribution" was a normative one: urging the judge, in the real positive social costs world, to make the award to whichever of the two contestants valued the good under dispute more, that is, the one who would have ended up with the benefit under the zero transactions assumption, after post judicial arrangements were negotiated. This latter has led to a large and highly critical literature from the Austro-libertarian point of view: Block (1977, 1995, 1996, 2000, 2003, 2006), Block, Barnett and Callahan (2005), Cordato (1989, 1992a, 1992b, 1997, 1998, 2000), Krause (1999), Krecke (1996), Lewin (1982), North (1990, 1992, 2002), Rothbard (1982) and Terrell (1999). There is only one supporter of Coase in this regard, who might be considered an Austro libertarian (but certainly not on this issue): Boettke (1998). For a rejoinder see Block, Unpublished C.

<sup>4</sup> With the zero transactions cost assumption, it entails no resource use to consummate this arrangement.

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F to overturn the resource allocation seemingly imposed by the court? Yes. For example, G, who values a cessation of the incursion and thus the survival of his garden at \$80, can offer \$60 to F, thus profiting to the extent of  $\$80 - \$60 = \$20$ . F would be happy to take this amount, since he, too, gains. F can pocket the \$60 he receives from G, and thus earns  $\$60 - \$20 = \$40$ .

So, again, Coase concludes that whether pollution occurs or not is invariant to the judicial decision; it depends, only, on the value each of our economic actors places on the pollution or the lack of it. In cases 1 and 2, F valued pollution more than G valued its absence, and the dirty air continued, despite different judicial rulings in these two cases. In cases 3 and 4, G valued non pollution more than F valued its presence, and the dirty air stopped, again, despite different judicial rulings in these two cases. In cases 1 and 3, G gets the judicial nod; in cases 2 and 4, F is the winner in court. But, pollution persists in cases 1 and 2, where F placed a greater value on this amenity than did G. Clean air was the order of the day in cases 3 and 4, where G valued the garden more than F appreciated the right to pollute. So, environmental soundness stems from competing values of F and G; it is not based on who prevails in court.

Perhaps this table will clarify all four of these cases (1, 2, 3, 4). It summarizes who wins the court case, who values clean air or pollution more than the other, whether pollution occurs (P), or not (nP), and whether a bribe occurs (B) or not (nB).

		Winner of the court case:	
		F	G
Who values rights more:	F	2 (P, nB)	1 (P, B)
	G	4 (nP, B)	3 (nP, nB)

In Block (1977) I dealt only with case 4, and now propose to stick closely to that one. Why? Brooks (2007) is critical of my contribution to my debate with Demsetz. I am responding to Brooks (2007). But, case 4 was the *only one* at issue between me and Demsetz. In contrast, Brooks ranges over all four of these cases.

Why then, did Block (1977) criticize Coase (1960) on case 4? I did so because in order for Coase's conclusion to be sustained (resource use is independent of court rulings in the zero transactions cost model) G *must* be able to bribe F out of polluting, since in this case F has been given the right to do so by the judge. In the numerical example given above, G *values* the right to keep his garden safe at \$80. He would be *willing* to pay, for example, the \$60 I "called upon him" to pay. But, suppose, just suppose, that G *does not have* this amount of money available to him to finance this arrangement. Coase (1960) is implicitly *assuming* that G has these funds at his disposal. Perhaps, he can take out a mortgage on his garden for this amount if he has no readily available money, we might suppose Coase (1960) to have been thinking. But, and here was my crucial point, suppose, just suppose, that not only does G lack

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ready money, he cannot even borrow on the basis of his garden, since it is worth *nothing* to anyone else. Yes, G values it at \$80, but this is only a *psychic* estimation. It means he wouldn't part with his garden for that amount, but *not* that anyone else would grant a mortgage to G on this basis.

In section II of this paper I offer nine separate comments and criticisms of Brooks (2007). I conclude in section III.

## II. Critique of Brooks (2007)

With this introduction, we are now ready to consider the contribution to this debate of Brooks (2007).

### 1. *Weak and strong form of the Coase theorem*

Brooks (2007) relies heavily upon this distinction between the weak and the strong form of the Coase theorem. He mentions the former no fewer than 15 times, and the latter on a full dozen occasions.<sup>5</sup> Yet, nowhere in the previous discussion does this language even arise. I search in vain through Demsetz (1979, 1997) and Block (1977, 1995 and 2000) for these words. True, Coase (1960) utilizes the word “strong” twice (he completely eschews “weak”) but in completely different contexts.

Coase (1960, p. 3, emphasis added) offers the following in this regard: “When the fence is erected, the marginal cost due to the liability for damage becomes zero, except to the extent that an increase in the size of the herd necessitates a *stronger* and therefore more expensive fence because more steers are liable to lean against it at the same time.”

Coase (1960, p. 11, emphasis added) says: “The standard British writers do not state as explicitly as this that a comparison between the utility and harm produced is an element in deciding whether a harmful effect should be considered a nuisance. But similar views, if less *strongly* expressed, are to be found. The doctrine that the harmful effect must be substantial before the court will act is, no doubt, in part a reflection of the fact that there will almost always be some gain to offset the harm.”

Needless to say, none of this has anything even remotely to do with any “strong” form of the Coase theorem. Therefore, it is at least initially a bit difficult to make sense of this criticism of Brooks' (2007). This latter author concedes that “... Block did not use the terms weak and strong Coase theorem in his initial paper...” Why, then, bring it up? But this is just the tip of the ice berg. Not only did I not use such language, neither did Demsetz (1979, 1997), nor Coase (1960).

However, all is not lost. Brooks' verbal inventiveness has a positive as well as a negative aspect. The danger is, of course, confusion. But the benefit is that it introduces a new perspective to the analysis: the distinction between the “weak” and “strong” Coase theorems.

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<sup>5</sup> I can make this statement in confidence thanks to modern technological tools, that is, word search.

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According to Brooks (2007): “Block's preoccupation with the strong version of the Coase theorem—with whether the final allocation is invariant to changes to property rights, leaves a number of important questions unsettled over the status of Demsetz's intent which is to focus on the weak Coase theorem.” I think this is a valuable<sup>6</sup> contribution on the part of Brooks (2007). However, the way I view it is that this claim undercuts Demsetz's side of his debate with me, since Coase (1960) makes no mention of the weak version of his theory, and the altercation between me and Demsetz concerned Coase (1960). If Demsetz wants to defend Coase, instead of making up new arguments as he goes, he might have been well advised to have stuck to what Coase (1960) actually said, instead of putting new words in Coase's mouth in an attempt to defend him.

That is to say, the pre Brooks (2007) debate on these issues concerned, solely, the “strong” Coase theorem. In my view, I was entirely in the right on that single matter, and Coase and Demsetz were completely in the wrong. Now, thanks to Brooks' (2007) introduction of the “weak” version of this theorem, Brooks is now in a position to take the side of Coase and Demsetz. Interesting. Brooks may even be correct in his claim that Demsetz has had the better of me as concerns the “weak” theorem; I shall not follow him there, as, it is my view that this was never part of the original discussion, and I would like to seek clarification on that before moving into these newer pastures.

## 2. No “refutation of Coase's analysis?”

An important part of Brooks' (2007) contribution is that he demonstrates that while Coase and I were discussing baseball (the “strong” theorem), Demsetz's critique of me, in part, involved football (the “weak” theorem). States Demsetz (1979, pp. 99-100):

“The alteration in the mix of output reflects an implicit wealth effect on the demand for flowers, as can be seen easily if a compensating increase in income is given to the garden owner when the factory owner has the right to use smoke-producing fuel, and, therefore, is in no way acceptable as a refutation of Coase's analysis.”

But this is unacceptable. Remember, the debate I am having with Demsetz concerns whether or not, in case 4, the G can bribe the F into stopping the pollution the court has decided he has a right to emit. But G can only do this if he has some *funds* with which to accomplish this goal. If the value he places on his garden is only psychic, if no one else values it at all such that it cannot serve as collateral, then G can do no such thing. Then, the judicial decision *does* matter for resource allocation (whether the smoke ceases or not), contrary to Coase, Demsetz. There is no room for any “compensating increase(s) in income” in this debate. Certainly not in my original (Block, 1977) critique of Coase (1960). And, ditto for Pareto optimality. This, too, is an interesting and even important concept. But, it forms no part of the Block-Demsetz debate, at least not in the way I interpret it.

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<sup>6</sup> It would have been more valuable, still, had Brooks (2007) quoted from Demsetz (1979 or 1997) directly on this point.

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I cannot help thinking that I was in a debate with Demsetz on, say, an issue involving baseball, and Brooks comes along and demonstrates that these two professors were correct, and me wrong, on a matter of football strategy. Well, maybe so, but as for me, I'll stick to baseball, in this case, before moving on to the gridiron.

However, I do owe Brooks (2007) a debt of gratitude. Thanks to his analysis, I now see more clearly that while Coase (1960) was discussing the strong version of this theorem, and I was criticizing for it, Demsetz (1979, 1997) was upbraiding me on weak Coase grounds. No wonder Demsetz and I passed each other like ships in the night. Where was Brooks when we needed him? Still in diapers, I suspect.

### 3. *Weak and strong for Brooks*

Brooks (2007) states: "The strong version of the Coase theorem states that if transaction costs are zero, then the allocation of resources will be identical irrespective of the initial assignment of property rights... Here the strong version of the Coase theorem holds."

"Oh, yeah?" as we say in Brooklyn. Just how does it "hold?" From what source does G get the *money* with which to arrange the post judicial transfer of rights, given the G is impecunious, and cannot rely on the capital value of the garden to serve as collateral? In the strong version of the Coase theorem, at least, there is no income transfer that would allow any such thing. We are left in the dark on this matter by Brooks, I fear.

What about the weak version? In the view of Brooks (2007, footnote omitted): "Over the course of several papers, Demsetz (1997) has argued that Block's conceptually distinct challenge to the Coase theorem misses the mark once it is accepted that Coase really had in mind a weak version of the Coase theorem namely; if transactions costs are zero, then an efficient allocation of resources will be achieved irrespective of the initial assignment of property rights."

Again, I find difficulty in accepting this. If "Coase really had in mind a weak version of the Coase theorem," why didn't he *say* so? And, if Coase (1960) really said this, why doesn't Brooks (2007) *cite* Coase to this effect? Why didn't Demsetz (1979, 1997) offer some evidence from Coase (1960) to this effect? I find no mention of the word "compensation," appear in that latter publication in the relevant sense of moving people back to an indifference curve, or making them indifferent to a previous welfare level.

Brooks (2007) states as follows: "Demsetz (1997) acknowledges that while the final allocation can change from one property rights assignment to another, he claims the final allocations are all socially optimal and that the social-optimality invariance is one of the central lessons of Coase. Demsetz claims that Block's psychic income charge is nothing more than an income effect and as such does not represent a conceptually distinct case of why the Coase theorem would fail."

But Demsetz and I never differed as to whether "final allocations are all socially optimal" under the assumption of zero transactions costs. Whether they are or not would take us far too far afield for the present discussion. Rather, Demsetz and I

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were discussing, or, better, now, thanks to Brooks (2007), *should have been discussing*, whether or not G would necessarily be able to make the payment to F, in the case where the judge ruled in favor of the latter. If G were not so able, then, as far as the allocation and use of resources, and that alone, in the *absence* of any moving people back to original indifference curves by compensating them, the Coase theorem in the zero transactions costs world cannot be sustained. That is the *only* thing of relevance to my (Block, 1977) critique of Coase (1960), at least under the heading of positive economics is concerned.

#### 4. *Income effect: ex ante and ex post*

Brooks (2007) is less than fully edified by my introduction of the concepts *ex ante* and *ex post* income effect. He (Brooks, 2007) complains that it “Block does not define the *ex ante* income effect, noting that ‘strictly speaking, the *ex ante* concept involves no income effect at all’ (Block 2000, p. 69).”

Why did I introduce<sup>7</sup> such terminology? When I teach classes, if I am not getting my point across, if I do not see the proverbial “light bulb” over the heads of, or light in the faces of my students, if I see puzzlement instead, I try to reiterate, but, use different words. I am of course not comparing Demsetz to any of my students;<sup>8</sup> however, I did feel frustration in not being able to convey my criticism to him at least to my satisfaction. So, I “tried, and tried again.” Part of my attempt was to create this new language in the hope that it would improve communication between us. I did say in this regard (Block, 2000, 68, emphasis added, now) “As I see matters, there are two issues floating around, confusing matters between Demsetz and myself. Let me at least initially call one of them the *ex ante* income effect, and the other the *ex post* income effect, *for want of any better terminology.*” This, I suggest, indicates that I was attempting to “think out loud,” to blaze a new path in an attempt to “reach” my debating partner.

Brooks (2007, 27) opines that “It is hard to see how the term *ex ante* income effect, which leaves out the possibility of any change in real income, will be accepted by economists...” True, no doubt. But, it was no part of my intention then, nor now when I reiterate use of this phrase, to accomplish that goal. I have hopes that if this terminology will did not convince Demsetz, and does not now do so for Brooks, that it may still shed light for others. Why? Because it focuses explicitly on the psychic income phenomenon (Block, 2000, 69), and this is *the* crucial part of my analysis. If the sole “wealth” of G consists of not money but psychic enjoyment, then it can neither serve as the bribe to entice F not to pollute if awarded by the court the right to do so, nor as collateral for a loan with this aim in mind.

#### 5. *Comparative statics*

However, this will hardly do for Brooks (2007, 27). For him, rather than psychic income being the lynch pin of the analysis, it is an error: “It is difficult to be

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<sup>7</sup> I confess, I am as guilty of Brooks (2007) in being adventurous with language. He introduces “strong” and “weak”; I was verbally inventive with “*ex ante* and *ex post* income effects.”

<sup>8</sup> If there were any such relationship between me and Demsetz, and there is not, it would be precisely in the other direction: I would be student of his.

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satisfied with Block's most recent defense of his psychic income case. The Coasian<sup>9</sup> position, at least in terms of the strong and weak versions of the Coase theorem, is irreducibly a comparative static exercise. Block's line of argument is akin to the position that one can say something about changes to a market price by just focusing on demand or supply independent of the other. And just as statements about price involve an exercise considering the twin blades of the Marshallian scissors, statements about the Coase theorem involve a comparative static exercise where the variable is the definition of property rights.”

About this, a few comments. First, it is more than passing curious to find a *positive* mention of the “Marshallian scissors” published in the *Quarterly Journal of Austrian Economics*.<sup>10</sup> Second, there is no kinship whatsoever between supply and demand and their independence from one another, on the one hand, and the topic under discussion, Block vs. Coase and Demsetz, on the other. The burden of proof on this one I think rests with Brooks, and not only has he not met it, I fear he does not realize that it rests with him. What does supply and demand, and/or Marshall's scissors, have to do with whether or not G can bribe F?

Third, and far more important, I maintain that the issues dividing me from Coase and Demsetz have nothing to do with a “comparative static exercise.” This is not to say that I oppose comparative static exercises, per se, as I do the Marshallian scissors. Rather, my claim is that this otherwise unexceptionable tool of analysis simply has no place in the present context. I appreciate Brooks' (2007) attempt to apply relatively sophisticated analytics, such as comparative statics; but, just because comparative statics can shed light on some economic issues, does not mean they can do so, here.<sup>11</sup> Why not? Because, remember, the sole issue between me, on the one hand, and Coase and Demsetz on the other is, will G necessarily be able to bribe F into stopping the pollution he has been given the right to engage in. This is a Yes or No question. Either G has this ability, or he does not. What do comparative static exercises have to do with this *one* question. Nothing at all.

However, Brooks (2007) is not without a response to this critique of mine. He says in this regard: “If one were to follow Block and focus on strictly one such scenario then all that one would learn is that if the gardener does not have the pecuniary means to protect her (sic)<sup>12</sup> property rights that the garden will wither and die. But that's not a statement about the Coase theorem in either its strong or weak form. One would still have to ask what would happen to the allocation of resources or its normative content if the property rights were allocated instead to the gardener in order to complete a statement of the Coase theorem.”

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<sup>9</sup> Shouldn't “Coasian” be spelled as “Coasean?”

<sup>10</sup> See Baird, 1987; Rothbard, 2004, ch. 5. States Baird (1987, 194): “Marshall was wrong when he claimed that demand is subjective and cost is objective. Both blades of the Marshallian ‘scissors’ are subjective categories.”

<sup>11</sup> “If all you have is a hammer, then every problem starts to look like a nail.” I do not say comparative static exercises are the only tools in Brooks' armament; but, they certainly do not apply in this case.

<sup>12</sup> I place (sic) near the word “her” since this is the first time politically correct language is introduced. The use of this type of nomenclature is especially off putting in the present case since Brooks (2007) is a new entry into this dialogue. Presumably, he is reporting on what went on before his arrival. But, previously, traditional language was employed. Neither of the plaintiffs nor defendants in the previous literature were female. It is somewhat surprising that such “punkish” practices (Salerno, 2009) would be allowed in the *Quarterly Journal of Austrian Economics*.



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Here, we reach some sort of agreement, Brooks and I. For we both maintain that my contribution to the positive part of this debate consists of little more than the insight that “all that one would learn is that if the gardener does not have the pecuniary means to protect her (sic) property rights that the garden will wither and die.” But, simple as this sounds, alright, alright, simplistic, this is *all* I was attempting to demonstrate to Demsetz.

But, and here Brooks and once again part company after an all too brief accord, while he regards this as trivial at best, mistaken at worst, I see it as the essence of the entire debate. For, once this is conceded, the main point of Block (1977) is reached: it *does* matter for the allocation of resources, even in the zero transactions cost model, whether the judge rules in favor of F or G. In case 3 as we have seen, *supra*, the court decision goes in favor of G and the pollution ceases, since G evaluates the contested rights more highly than F. In case 4, G sues, but loses. The same result ensues: no pollution. Again, because G values a soot free garden more than F assesses the right to dirty the air. But, this result depends, *fully, completely and totally*, on whether or not G can compensate F for giving up the right to emit smoke particles he won in court. If G can always do so, then Coase, Demsetz and Brooks are right and I am wrong. If there are at least *some* cases where G is unable to bribe F in this manner, then these three worthies are mistaken, and my analysis is correct.

So, are there *any* instances in which G cannot through financial compensation overturn the court ruling? Yes, yes, yes, a thousand times yes: when G has no money, and no collateral on the basis of which he can borrow some, then resource allocation is *not* invariant to judicial decision making. And when, pray tell, does this occur? When G’s property, the garden, serves only as psychic income for G; it is of no value to anyone else.

#### 6. Zero wealth assumption

The next arrow in Brooks’ (2007) quiver is a query regarding the assumption of zero wealth:

“Just how such a poor farmer meets her (sic) land taxes or buys any inputs in the market is something of a mystery. Consequently, though the garden may not have any explicit value on the market, it is hard to imagine a farmer who cannot muster any market income from her (sic) other assets. And therein lies a trace of an answer why Demsetz chose to discuss the farmer’s market-valueless garden in a setting which the farmer’s income was otherwise positive. Block’s suggestion that the farmer has no fungible income is followed in order to strictly conform with the strictures of his case.”

But this too does not pass muster. The reason? It concerns the burden of proof. I readily concede to Coase (1960) and to Demsetz (1979, 1997) that in the fourth case G *may* be able to bribe F into installing a smoke prevention device; and, if so, then the Coase theorem as it pertains to the zero transactions cost assumption is valid. But this is too low a barrier to require of Coase (1960). It is absolutely incumbent upon him to show not that his postulate *may* hold true in the zero transactions cost world. Oh, no.

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Much more is entailed, if the theorem is to hold true. In addition, Coase, or any of his legion of defenders must demonstrate that this is a *necessary* result. And this *cannot* be done if G has no other income or wealth whatsoever, apart from psychic enjoyment, which is not tradeable. Brooks (2007) calls upon us to imagine a farmer who does have enough economic power to bribe F into compliance with the Coase theorem. Well and good, the Coase theorem is safe under these conditions. But this is simply not good enough. Coase is obligated to demonstrate not that his postulate might be true under *some* wealth assumptions, but under them all, and this he fails to do.

In Block (2000) I had this to say about the wealth of G: “In Block (1977a, 1995a) I called the “farmer” a “gardener,” and endowed him with only one flowerpot to indicate that he would not have the wherewithal with which to bribe the polluter.” If Brooks’ interpretation of Demsetz<sup>13</sup> is correct, then the latter did not play fair. He brought in an adventitious consideration: zero wealth. But, I find no evidence for this interpretation in Demsetz (1979, 1997). Brooks (2007), again, fails to directly cite Demsetz on this point. It is therefore difficult to avoid the conclusion that it is Brooks (2007), not Demsetz, who in this one case is failing to live up to the usual scholarly requirements.

When I try to explain present discounted value to my students, I ask them to assume that there is no inflation, and that the money receivable in the future is guaranteed at the due date. That is, I am trying to *abstract* from risk, uncertainty, inflation, to get to the core, the essence, of discounting future income streams with the interest rate alone. Suppose one of my students were to object to this pedagogy on the ground that it is unrealistic. There is *always* inflation, he might argue, and we simply do not live in a risk free environment. Such a student would of course be correct. Not to object, but on the grounds for his objection. Such a student would be borrowing a leaf from Brooks (2007) in his rejection of the simplifying ceteris paribus assumption. Yes, Brooks’ (2007) point cannot be denied; it would be the rare G who has *no* funds whatsoever. But, how else can we bring into sharp contrast precisely what Coase (1960) is saying, and what Demsetz (1979, 1997) is defending? The point that Brooks misses is that this is contrary to fact conditional: *if* G had no other valuable commodity, *apart* from the psychic benefit of a garden, *then* the Coase theorem pertaining to the zero transaction costs world would be fallacious. Is it *possible* that this be the case? Of course. Then, this Coase theorem does not hold, which is the thesis of Block (1977).

### 7. Sidestepping

Says Brooks (2007): “I sidestep Block's argument and assume the factory owner will accept as payment the farmer's psychic income.”

I am tempted to dismiss this statement as a typographical error. My only wonder is that it escaped notice of the author, and as well the editors and referees at the *Journal* that published Brooks (2007).

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<sup>13</sup> Brooks (2007): “...therein lies a trace of an answer why Demsetz chose to discuss the farmer's market-valueless garden in a setting which the farmer's income was otherwise positive.”

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But, if we are to take this statement seriously as really reflecting the views of its author, it can only be considered highly problematic. The entire point of my relying on “psychic income” in Block (1977) was precisely that the factory owner will *not* accept as payment the farmer's psychic income. And, in this case, the judicial decision matters, greatly, for the allocation of resources, contrary to Coase (1960). But if F *could* accept such income as payment, I readily concede, my publication (Block, 1977) would be rendered erroneous. Indeed, it would be considered incoherent, and properly so. However, this is impossible.

Let us review the concept of psychic income. It is the psychological benefit that accrues to the owner, in this case of a garden but in the more general case, any possession. It is the subjective gain the owner of the property in question derives from his ownership rights. In terms of a contrary to fact conditional, psychic income means that a possessor would not part from the property in question for any amount of money held to be of lower value than the object from whence the psychic income flows. So, for example, if G gains \$100 in psychic value from the garden, he will not sell it for any price lower than that.

However, such a benefit is not at all transferrable to anyone else. If there is *only* psychic value in the garden for G, then, by stipulation, no one else can value it at all.<sup>14</sup> If there were someone else, F, or a third party, who placed any value on the garden *at all*, then the psychic value placed upon the garden by G would *not* exhaust its benefits. Rather, there would be some left over for others, and, they would, presumably purchase the garden, or accept it in payment, as long as the price was lower than their estimation of its value.<sup>15</sup> But this is *precisely* what my example is set up to obviate. That is, psychic “income” is the “income” that *cannot* be transferred from one person to another. It is subjective. It is not fungible. Thus, there *are* no “potential gains from trade” (Brooks, 2007) from such a commercial interaction. It is simply not true that there is any “psychic income the farmer would be willing to give up.” He logically *cannot* “give up” any such thing. Well, I suppose he could give it up if he changed his taste, and no longer enjoyed owning the good in question. But, in no case can he explicitly *transfer* this income to anyone else.

### 8. Social efficiency

Brooks (2007) declaims as follows: “Demsetz appears to be correct in claiming that Block's argument is nothing more than a playing through of the income effects: Although the final allocations differ across the two scenarios, the two different social outcomes are socially efficient. And psychic income effects can be easily incorporated into the analysis and appear as the difference between the budget constraints *B2* and *Bx*.”

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<sup>14</sup> I abstract from the possibility that F can value the psychic income of G. Yes, F may be pleased with G's psychic income, with the fact that G derives utility thereby, but such a possibility never once arose in the Coase-Demsetz-Block debate. To the extent that Brooks' comment has that debate as its subject matter, this possibility is irrelevant. But, can G possibly *pay* F in the coin of his, G's, psychic benefit? In the usual understanding of paying, if X pays Y an amount Z, then X no longer has Z; instead, Y now has Z. I conclude that, were this at all relevant, we would have to conclude that G could pay F with his (G's) psychic benefit at most only in a very poetic, not economic, sense.

<sup>15</sup> I am now assuming that F, or someone else, values *his own* psychic value in G's garden; that is, that F would *himself* value this garden on a psychic basis, even though the garden has no (other) commercial value.

“Social efficiency,” whatever that may mean,<sup>16</sup> played no role in my (Block, 1977) criticism of Coase (1960). If I have somehow erred with regard to this concept, it is thus irrelevant to my debate with this Nobel Prize winning (1991) economist. It smacks of interpersonal comparisons of utility. Brooks (2007) says: “While it is undoubtedly true that the garden will wither and die if the property rights are granted to the factory owner and the farmer's wealth is only in the form of psychic income, it is simply not true that such an outcome is necessarily socially efficient.” At the risk of being repetitive, the issue between me and Coase (Demsetz) did not at all turn on the question of whether anything was “socially efficient.” Rather, the altercation concerned whether or not the Coase theorem held, without a specific obviation of psychic income, which Coase ignored. To put this into Brooksonian terminology, we were discussing the “strong form,” not the “weak form,” of the Coase theorem.

### 9. *No loss?*

According to Brooks (2007): “...starting from the reality in which there is no flower garden, even though the farmer is willing to pay more to have a garden than it costs to install the pollution abatement equipment, she (sic) has no income, psychic or otherwise, to support that preference. And since she has no garden to begin with, she bears no loss when the factory pollutes the environment. In that setting, there is some merit in Demsetz's position as one plank of the weak version of the Coase theorem holds after all. When the farmer has no income, psychic or general, and the property rights are assigned to the factory owner, the final allocation is socially optimal.”

I find it difficult to accept this assessment. If there is no garden at all, how can anyone “willing to pay more to have a garden than it costs to install the pollution abatement equipment.” Assuming, now, that there is indeed a garden in existence, but that G does not have it, this case splits up into two more. First, G can attain psychic income (“existence value”) from this garden even if he does not own it; second, G can attain psychic income from this garden only if he owns it. But, how either of these scenarios translate into seeing “merit in Demsetz's position” is unclear.

Further, how can G be “willing to pay more to have a garden than it costs to install the pollution abatement equipment” when he “has no income, psychic or otherwise”? With no income at all, of any type or variety, not only can he not pay “more,” he cannot afford *anything* at all. And, why are we robbing G of his psychic income, the only income he has? In the debate between me and Demsetz, both of us posited that G had, at least, psychic income. In disallowing this, Brooks would appear, once again, to be stepping away from the intellectual quarrel I engaged in with Demsetz, the ostensible subject matter of Brooks' essay of 2009.

Further, just because G has “no garden to begin with,” it does not at all follow that he “bears no loss when the factory pollutes the environment.” G does lose out, as long as his *psychic* income does not require actual ownership of the garden (“existence value.”)<sup>17</sup>

<sup>16</sup> Then, too, I confess, I am not all that enamored of “social indifference” Brooks (2007).

<sup>17</sup> It might be a tad difficult to demonstrate (Gordon, 1993; Herbener, 1979; Rothbard, 1997) any such thing. Were it ever allowed by law, that is, could people sue for this, a gigantic Pandora's Box would be opened up, where anyone could pretty much claim any values he wanted.

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Yes, there may indeed be some “merit” in Demsetz’s defense of the weak version of the Coase theorem, but this is not at all what Demsetz and I were disputing. Rather, our divergence was with regard to the strong version of this theorem; thus, Brooks once again removes himself from our dispute.

Brooks (2007) says that “Block grants too much ground to Demsetz’s interpretation of the weak version of the Coase theorem.” I don’t see how I grant *any* ground to “Demsetz’s interpretation of the weak version of the Coase theorem.” We simply were not discussing this, so it is difficult to see how I could grant any ground to it, let alone “too much.”

### III. Conclusion

Brooks (2007) makes several telling points against Demsetz (1979, 1997) which I have not discussed, since I was focusing on Brooks’ criticisms of me. For this he is to be congratulated.

Another signal contribution of Brooks (2007) is that he manages to forge what might be called an “Austro-Demsetzian”<sup>18</sup> perspective

I am also very grateful to Brooks for focusing a spotlight on this debate between me and Demsetz. He is the only one to have done so in the scholarly literature, and I think this issue, no matter what are the rights and wrongs of it, is important enough to deserve some attention. But, I cannot agree with his criticisms of my part in it.

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<sup>18</sup> Foss (2009) has created this phrase. Foss uses this term in an entirely different context (monopoly theory), but it is certainly applicable in the present case. I thank Peter Klein for alerting me to this.

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