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**Coase and the Economics of Crime**

Laurent Carnis\*

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**Abstract:** *“The problem of social cost”* is a major piece of Coase’s legacy. It constitutes the foundation of the neo-institutionalism movement. This article tries to provide a solution to situations characterized by disputes on the use of resources. We propose a libertarian and Rothbardian re-examination. In the first section, the Coase theorem is the object of a personal appraisal. The second section stresses the common points between the Coasian approach and the classical school of the economics of crime. The third section examines the consequences of both of these theories for public policy.

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\* Researcher at the French National Institute for Transport and Safety Research. He works for the GARIG department. He is also an associated researcher of the LAEP department of the University of Paris 1. A first version of this paper was delivered during the Austrian Scholars Conference in Auburn (Alabama), March 2004 for a session on Law and Economics with Walter Block, Peter Klein and Roy Cordato. The author would like to thank Nicolai Gertchev for his precious comments. The usual caveat applies.

## 1 Introduction

“The problem of social cost” constitutes a true revolution for analyzing the harmful effects resulting from incompatible uses of resources. The traditional pigouvian analysis supposes that governmental intervention limits such situations of conflict. The approach in terms of private and social costs focuses on the deficiencies of the market. On the opposite, Coase suggests that some harmful acts should not necessarily imply compensation. The true criterion he refers to is the total available product it is possible to reach. The different results have to be compared for the different social arrangements (Coase, 1960)<sup>1</sup>. He therefore emphasizes the importance of the institutional environment. The Coasian analysis shows that many flaws characterize the traditional analysis of welfare economics. The Coasian analysis stands as an alternative.

This article deals more particularly with the formal links between the Coasian theory and the classical school of the economics of crime (Carnis, 2002)<sup>2</sup>. The first section develops the different results that the Coasian analysis achieves. It emphasizes the consequences of the Coase theorem, which have been very much adopted by the mainstream economists. The second section analyzes the common points between both theories and stresses their entangled character. The third section is concerned with the implications for the enforcement of law and order.

This article is based on the Rothbardian theory of property rights. This theory implies that legitimate property rights have four possible origins: self-ownership, homesteading, exchange of previous legitimate property and production (Rothbard, 1982)<sup>3</sup>. Justice supposes the respect of these legitimate property rights and considers all physical invasions of legitimate property as crimes<sup>4</sup>. This theory constitutes the general framework from which it becomes possible to cast a new light upon the Coasian analysis. This contribution can be considered as being one possible Rothbardian re-examination of Coase’s insights.

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<sup>1</sup> Ronald H. Coase (1960), “The Problem of Social Cost”, *The Journal of Law and Economics*, Vol. III, October, p. 40 and 43.

<sup>2</sup> For a definition of the classical school of crime, see Laurent Carnis (2002), “Economic Approach of Crime: Mainstream Economics vs. Rothbard”, *Paper delivered in the honor of the 40<sup>th</sup> Anniversary of Murray Rothbards Man, Economy and State*, March, Ludwig Von Mises Institute, Auburn, Alabama.

<sup>3</sup> Murray N. Rothbard (1982), *The Ethics of Liberty*, Humanities Press, p. 33

<sup>4</sup> It means the victim bears a true damage

## 2 The Coase Theorem: a personal and critical appraisal

Coase's contribution on the problem of social cost deals with actions having harmful effects for another party. The solution Coase proposes consists in choosing the social arrangement that permits to increase the total available production for society.

### The General Framework

The general premise of Coasian analysis is to consider the problem we face as not being a unilateral one (A harms B), but having a reciprocal nature (A can harm B by undertaking a specific action, but if B prevents A from acting in order not to be harmed, A bears a damage from B.) (Coase, 1960)<sup>5</sup>. Consequently, Coase assumes that disputes result from situations where the rights are either unclearly defined (clean air) or are not correctly identified (problem of noise and its intensity). He supposes also cases where there are some contradictions between the exercise of the different (bundles of) rights. For Coase, a dispute between parties is the outcome of oppositions between legitimate claims to exercise a right (Coase, 1960)<sup>6</sup>. For the sake of an example, let us suppose two kinds of vehicles (cars and trucks) on the road network. Their drivers hold, according to the Coasian analysis, a legitimate property right of using the road. Unfortunately, there is an incompatibility between both these vehicles. The heterogeneity of their physical characteristics can drive to a surplus of road accident and can be the origin of social losses. Typically, we are in presence of a conflict about the use of a scarce resource.

This analysis has never considered the possibility that among claims some could be illegitimate and could constitute a true invasion of a legitimate property right (Carnis 2002)<sup>7</sup>. In the above example, it does not finally matter whether the accident means a violation of a legitimate property right on the body of the victim or rather on her vehicle. What is truly at stake here is the existence of a damage. Therefore, a strong criticism can be raised against the Coasian analysis for the lack of relevance given to the ethical dimension of property rights. It is symptomatic that through his long article Coase evokes the decisions of judges without never dealing with the principles of justice. And

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<sup>5</sup> Ibid. p. 2.

<sup>6</sup> Ibid. p. 13.

<sup>7</sup> Ibid., p. 5.

yet, these principles should motivate the judges' decisions. Is it meaningful to separate the notion of rights from what is right (North, 2002)?<sup>8</sup> This remark repeats a critique made previously by Rothbard on the absence of a theory of justice characterizing the mainstream works (Rothbard 2000 (1974))<sup>9</sup>.

The general objective of Coasian economics is concerned with the search for the maximum of production (Coase, 1960)<sup>10</sup>. "If we are to attain an optimum allocation of resources, it is therefore desirable that both parties should take the harmful effect (the nuisance) into account in deciding on their course of action" (Ibid.)<sup>11</sup>. To reach this objective requires making some tradeoffs between the different activities, because of some contradictions between plans of production. This tradeoff is made possible by establishing a scale of value permitting the comparison. The easiest way to proceed is the comparison of the different levels of output for the use of the same resource. If we follow our example, it means we have to compare the different wealths tied with the use of the different vehicles : the freight transport for trucks and the output of the car users. Consequently, the allocation of resources among the population depends on the specific search for efficiency without consideration for the legitimate owner.

What answer should be given is, of course, not clear unless we know the value of what is obtained as well as the value of what is sacrificed to obtain it (Coase 1960, p. 2)<sup>12</sup>.

The efficient situation is reached when the social cost is minimized. The minimization of the social cost implies that the less productive use of resources will be forgone or, to put it differently, the most highly use of resource has to be preferred. The social cost is minimized when there is an additional production or more goods and services to share among the population. If production is 100 monetary units in the case of the truck activity and only 90 from the use of cars, it follows priority has to be given to the truck for using the road network. This perspective is very important insofar as it implies it

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<sup>8</sup> Gary North (2002), "Undermining Property Rights: Coase and Becker", *Journal of Libertarian Studies*, Vol. 16, no 4, fall, p. 80 and 858

<sup>9</sup> Murray N. Rothbard (2000 [1974]), *Egalitarianism as a Revolt Against Nature*, 2<sup>nd</sup> Edition, Ludwig Von Mises Institute, Auburn, Alabama, p. 91-96

<sup>10</sup> Ibid., p. 10

<sup>11</sup> Ibid. p. 13

<sup>12</sup> Ibid., p. 2

becomes also possible to make some tradeoffs between rights, independent from their legitimacy. Indeed, to give the right of using a specific resource consists, as a matter of fact, in allocating the property rights on this resource. The objective of efficiency implies then the possibility of excluding the current owner from his own legitimate property (North, 2002)<sup>13</sup>. Consequently, the legitimate owner sees his own right to exclude trespassers annulled, while others benefit from these opportunities to exclude legitimate owners from their own properties. The property right is no more absolute but becomes conditional, determined by a questionable trade-off (Carnis, 2002)<sup>14</sup>. Finally, it undermines the foundations of property rights.

By elevating the “right to inflict damage” to the same level as the right to demand compensation for a violation of a property right, Coase has effectively compromised the latter right by making a potential right out of the ability to inflict damage. The application of Coase’s argument would destroy property rights by attempting to extend the status of property right to a man’s ability to damage his neighbor’s property (North, 2002)<sup>15</sup>.

### **The Zero Transaction Cost Situations**

The first part of the Coasian analysis supposes a zero transaction cost world. He assumes that the conditions of the pure and perfect competition model are verified. Under these conditions, the maximization of the value of production becomes possible and is reached through market transactions. The market process will direct the resources towards the most productive owners independently of the initial allocation and the legal rule. However, Coase recognizes the process is not possible if rights have not been previously established. “. . . Without the establishment of this initial delimitation of rights there can be no market transactions to transfer and recombine them” (Coase 1960)<sup>16</sup>. We must stress here the contradiction that lies between the proposition of zero transaction cost and the alleged necessity of previously defined property rights to initiate the process. Indeed if it is assumed that there is no transaction cost, then the absence of previously

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<sup>13</sup> Ibid., p. 89-90

<sup>14</sup> Ibid., p. 3

<sup>15</sup> Ibid. p. 90

<sup>16</sup> Ibid. p. 8

defined property rights would not constitute a difficulty because it would be possible to allocate these rights (for the initial assignment) to the most productive use at zero cost. On the very opposite, the need for clearly defined owners suggests that some costs are at stake and that there is no reason why it would not be the case for the entire process described by Coase. Here, there is a serious contradiction within the Coasian framework.

This contradiction is not taken into account by some mainstream economists who assume the conclusions and popularize the results by giving them the well-known name of the Coase Theorem. The Coase theorem consists in two different claims: an efficiency claim and an invariance claim.

If one assumes rationality, no transactions costs, and no legal impediments to bargaining all misallocations of resources would be fully cured in the market by bargains (Calabresi quoted by Zerbe, 2001)<sup>17</sup>.

Consequently, the market process would be able to solve all inefficient situations. However this result occurs only when the conditions of perfect competition are assumed. Consequently, the theorem does not hold any more when there are high positive or prohibitive transaction costs. This efficiency claim stresses both the efficiency of the market process for situations with low transaction costs and its inefficiency for other situations. In fact, it delimits the area of efficiency of the market process and establishes accordingly the limits of a free market process. If the car users hold the right of using the road network, the truck companies can offer a compensation of 90 monetary units for obtaining the car owners' renunciation to use the road. The level of production then is 100, i.e.  $90 + 10$ . If the truck companies benefited previously from the use of the road network, the production would still be 100.

The claim of invariance suggests that legal rules do not affect the allocation process. This result is highly significant insofar as it implies a separation between the economic approach and the legal one. Then, in such a world of zero transaction costs, the allocation of resources would be independent from the Law. In a sense, the legal dimension does not matter. The notion of property right becomes meaningless.

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<sup>17</sup> Richard O. Zerbe Jr. (2001), *Economic Efficiency in Law and Economics*, New Horizons in Law and Economics, Edward Elgar, p. 85

In a world of perfect competition, perfect information and zero transaction costs, the allocation of resources in the economy will be ... unaffected by legal rules regarding the initial impacts costs resulting from externalities. (Regan quoted by Zerbe, 2001)<sup>18</sup>.

The main conclusions of this analysis lead to the adoption of the classical model of competition (model of pure and perfect competition) as the standard, according to which actual situations are being considered optimal or not. In a zero-transaction-cost world, the rule of law is immaterial. However, it must be stressed that some economists, as Zerbe for instance, reject this classical model as the standard to abide by. They assert that transaction costs are ubiquitous in the real world. Consequently, to consider a world without transaction costs is to assume a completely imaginary world, or a meaningless one. Although these economists do make some progress by admitting the only, real, world that we are continuously facing, and which is characterized by imperfect information and costs of negotiation, there is no progress whatever concerning the importance of the rule of law and its ethical foundation (Ibid.)<sup>19</sup>.

Even more problematic is the endorsement of the Coasian model by some Austrian economists. Indeed Boudreaux seems to share the efficiency claim. He asserts:

Rather than focus on what James Buchanan ... calls the “invariance version” of the Coase theorem – according to which alternate assignments of liability generate the very same physical allocation of resources – it is truer to Coase’s essential message to focus on the fact that ability to bargain freely is practically necessary and almost always sufficient, to internalize the full subjective costs of resource use upon owners of property rights. (Boudreaux, 1998)<sup>20</sup>.

Although Boudreaux is clearly right by asserting costs are subjective because judgments of value are subjective, he is wrong when he deduces an inclination to negotiate for both

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<sup>18</sup> Ibid. p. 85

<sup>19</sup> Zerbe makes a strong criticism of Coase’s analysis, the solution of compensation proposed by Hicks and Kaldor. Instead of taking into account the transaction costs, Zerbe proposes new criteria, which are unfortunately characterized by the same flaws (possibility of interpersonal comparisons, confusion between actions and willingness to pay or to accept, etc.) (Zerbe, 2001, particularly chapters 1 and 2)

<sup>20</sup> Donald J. Boudreaux (1998) The Coase Theorem, in *Peter J. Boettke (ed.), The Elgar Companion to Austrian Economics*, Edward Elgar, Chapter 27, p. 186

parties to reach a situation of efficiency. For instance, a landowner can refuse to sell his piece of land to a farmer who could increase the production of corn by cultivating it. The landowner could prefer to keep his property because this way he obtains higher psychic revenue. The farmer could offer \$ 100.000 to acquire the piece of land, but the owner could refuse. Maybe one reason, which explains this behavior, is that his psychic income is increased by the existence of the external effect. He takes pleasure in restraining the production of the farmer. For the case of the road network, the car user could refuse compensation because he benefits from psychic revenue provided by the use of his car (feeling of freedom and of autonomy). These examples clearly show there is no such a situation of efficiency. Market transactions permit only to satisfy some plans followed by individuals according to their own scale of value. That some external effects are internalized through market transactions is a consequence, but on no account is it objective.

In fact, Boudreaux is assuming that the definition of rights obeys a criterion of efficiency. In this way, his analysis is similar to those of Demsetz and Posner. But is the allocation of rights only, and really, a question of efficiency?

The Coase theorem is the explicit recognition that ability to bargain induces people who exercise their property rights to internalize the costs of these exercises – that is, that an owner of a right includes non-owners' assessments about a particular exercise of that right as part of his own assessment (Boudreaux, 1998)<sup>21</sup>.

Still more problematic is the situation with high bargaining costs. The solution then is found in the awarding of the right by the court to the parties that value it most highly (Ibid.)<sup>22,23</sup>. Consequently, awarding the right to the person that will present the most highly productive use constitutes the solution to the dispute. In this sense, efficiency is the objective followed by the court<sup>24</sup> and is defined as enhanced production of physical goods. However, the resolution of conflicts by researching an objective of efficiency is contradictory with the assertion of subjective valuation, previously made. Indeed, if

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<sup>21</sup> Ibid. p. 181

<sup>22</sup> Ibid. p. 182

<sup>23</sup> It supposes such an ability of appraising the different productions by the judges and to yield such evaluation at an costs inferior than those established by the market.

<sup>24</sup> Such as assertion is doubtful because it assumes the judge is following this objective and not his particular interest of personal interpretation of what constitutes the efficient solution at the level of society.



the judge awards the right by weighting the different costs, this supposes he is able to identify them and to define an objective scale of value before even making comparisons. But one consequence of the subjective valuations is the impossibility to add them up and to make interpersonal comparisons (Rothbard, 2000 (1974))<sup>25</sup>; 1991<sup>26</sup>). Consequently, it is contradictory to assert a subjective dimension for the personal valuations while striving after efficiency through the modeling of law.

### The Existence of Transaction Costs and The Consequences for This Analysis

The next step of Coase's reasoning consists in introducing transaction costs. Then Coase shows the importance of the initial delimitation of property rights (Coase, 1960)<sup>27</sup>. Indeed, a new arrangement would be possible only if the additional value of the production is higher than the costs of transaction. From the example of the conflict on the use of the road network, if the transaction costs, which permit the transfer of the right of using the road network, is 12 and the car users are holding the right, then it is no more possible to reach the efficient situation. Indeed, the total costs would be 102: 90 for the compensation of car drivers and 12 for the transaction costs. But the available production for the truck companies is only 100. If the truck companies hold the right, the efficient situation is already reached and no transaction cost is implied. The transaction costs are perceived as obstacles on the path from one equilibrium toward another<sup>28</sup>.

Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about. (Ibid.)<sup>29</sup>

<sup>25</sup> Ibid. chap. 4, p. 91; 1997, chap. 6, p. 125

<sup>26</sup> Murray Rothbard (1991), *L'économie du bien-être: une reconstruction*, in *Economistes et Charlatans*, Collection laissez faire, Les Belles Lettres chap. 4 ; see also from the same author, "Law, Property Rights, and Air Pollution" in *The Logic of Action 2, Applications and Criticism from the Austrian School*, Edward Elgar (1997) and *Egalitarianism as a Revolt Against Nature and Other Essays*, 2<sup>nd</sup> Edition, Ludwig Von Mises Institute, Auburn, Alabama (2000)

<sup>27</sup> Ibid. p. 16.

<sup>28</sup> If we follow North's analysis on institutions and the institutional change, there is a path dependency. See Douglass C. North (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, pp. 93-94.

<sup>29</sup> Ibid. p. 16.

Consequently, the new combination is restrained by the previous allocation, so that it can be impossible to reach the objective optimal allocation. For these situations, the market transactions and the market process are unable to yield an efficient situation. Coase stipulates three solutions to solve these inefficiencies, which are designed as the “so-called” market failures.

The firm itself represents one solution. It permits to internalize the problem of allocation of resources by solving it inside the firm<sup>30</sup>. The manager then decides the allocation of resources (Ibid.)<sup>31</sup>.

He chooses the best use of resources for the firm in order to maximize the profit<sup>32</sup>. Two constraints limit this solution. The first one is relative to the cost of coordination or the cost of organization inside the firm itself compared to the cost of market transactions. The additional value yielded by the production of a firm has to be higher than the costs of its creation and its functioning, and has to present a higher net value than that of the market. The second limitation stems from the fact that the firm is assumed to own various properties about which there are a conflict. If the firm was not the owner of these resources, the problem would then not be solved. In the case of our example, the solution could take the shape of a private owner of the road network, which decides the type of user that could benefit from the use of the resource. In that way, such a system has already worked on a small scale in the case of the highway, which excludes bicyclists, pedestrians and any low-speed vehicles.

Another, second, solution is governmental intervention through regulations, which “state what people must or must not do and which have to obey” (Ibid.)<sup>33</sup>. In this case, the government decides to allocate the resources in the manner it seems as optimal. The state can mobilize its apparatus and use violence to reach its goals. Concretely, for our case, it could take the form of a restriction of the truck use during the week-end, as it is actually in France. Special-purpose and very heavy or large vehicles have to be escorted

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<sup>30</sup> For a presentation of this paradigm, see Ronald Coase (1937), “The Nature of the Firm”, *Economica*, (4).

<sup>31</sup> Ibid. p.16.

<sup>32</sup> We do not deal here with the problem of divergence between the objectives of the manager and the owners of the firm. Let us suppose, in order to simplify the problem, that the owner is also the manager of the firm.

<sup>33</sup> Ibid. p. 17.

by police motorcycle. Another way to deal with the conflict is to impose a special speed regulation for the heavy vehicles or a differentiated speed limit for other vehicles.

Just as the government can conscript or seize the property, so it can decree that factors of production should only be used in such-and-such a way. Such authoritarian methods save a lot of trouble (for those doing the organizing). Furthermore, the government has at its disposal the police and the other law enforcement agencies to make sure that its regulations are carried out (Ibid.)<sup>34</sup>.

The intervention of courts constitutes the third solution to the problem of allocating resources. The legal assignment by courts is justified again by attributing a role of economizer to judges. They would be able to allocate the resources to their highest productive uses. The analysis of court decisions by Coase seems to conclude that globally the judges follow an economic criterion for awarding the rights.

A thorough examination of the presuppositions of the courts in trying such cases would be of great interest . . . Nevertheless it is clear from a cursory that the courts have often recognized the economic implications of their decisions and are aware . . . of the reciprocal nature of the problem. Furthermore, from time to time, they take these economic implications into account, along with other factors, in arriving at their decisions (Coase, 1960)<sup>35</sup>.

This interpretation of the court activity raises the question how only one person, the judge, would be able to gather the appropriate information to decide the optimality of a specific arrangement of rights. This supposes the judge benefits from a specific quality of superiority on the other members of society. Moreover, this conception neglects the possibility of interference with the judge's own values. The judge could consider efficiency would justify that his political friends have to be the only owners of resources. He can use the legal process to promote his own financial interests or his own conception of what efficiency must be. Is there only one expression of what is an efficient allocation? Can the judge's conception of efficiency differ from economist's one? The most crucial limit to this solution, that Coase has never dealt with, is relative to the cost of functioning of the courts. A very complex conflict can require huge spending; other cases could

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<sup>34</sup> Ibid. p. 17.

<sup>35</sup> Ibid. p. 19.

cost more than the gains the parties would earn. Then what is the solution to follow in presence of “judicial failure”?

The different solutions proposed by Coase invite to more criticism to such an analysis. Indeed the possibility of giving to the State the outrageous power to reallocate the rights stresses the conditional character of such rights. Coase himself seems to share the opposition between the legal arrangement of rights (by voluntary exchanges) and their alteration by a violent intervention (Coase, 1960)<sup>36</sup>. However we must concede that Coase put some limits to the State intervention (as a solution) through a comparison between the costs of such an allocation and those of the market process and also by sustaining that policy-makers generally over-estimate the gains of government interventions. The solution would then be to compare the costs of the “market failure” to the costs of the “government failure” (interventionism + judicial process). But again, how is it possible to compare subjective valuations at all?

How can Coase assert a governmental intervention could reach optimal allocation when there is a tendency to over-estimate the benefits derived by such an intervention? In fact, Coase has opened a Pandora’s box. He justifies the governmental hindrances without even defining correct means to limit sub-optimal interventions. Since economists’ advances on the issues of bureaucracy and rent-seeking activities, it is well-known the governmental agents will use of their power to justify more control on the economic activity and more State interventions, upon which ultimately depend their own positions.

To sum up the argument, the intervention of the government permits to reduce the transaction costs by allocating the resources by force. This argument, developed by Coase, is interesting because it suggests that interventionism or the judicial process can solve ultimately the problem of allocation. The government or the judge will be able to identify the highest productive use of resources and appears as being a cost economizer and a social engineer. However, it raises a crucial issue for the Coasian analysis. Why and how can the governmental agent or the judge hold better information than the private agents? The different works of Mises on the problem of economic calculation and the

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<sup>36</sup> Ibid. p. 17.

contributions of Hayek on the problem of information show clearly the superiority of the market process on central planning (Hayek, 1991 [1953])<sup>37</sup>, (Mises 1990 [1920])<sup>38</sup>.

### **Coase's Approach and The Economics of Crime**

Some scholars deduce from Coase's work the ability of the market to tend towards efficiency and to solve the disputes about different uses of the same resources. They assume implicitly the market performs well when there is no transaction cost. The pure and perfect competition is conceived as the standard from which efficiency can be appraised. In fact, the zero transaction cost world constitutes at best a normative approach. Another possible interpretation is to show the importance of legal assignments. Indeed, Coase agrees that the real world deals with positive costs of transaction (Coase, 2000)<sup>39</sup>. The legal allocation becomes very important insofar as it constitutes a constraint for the objective of reaching the optimal allocation with previously attributed rights, and a resource to recombine these previous assignments

In a world in which there are costs of rearranging the rights established by the legal system, the courts, in cases relating to nuisance, are, in effect, making a decision on the economic problem and determining how resources are to be employed. It was argued that the courts are conscious of this and that they often make, although not always in a very explicit fashion, a comparison between what would be gained and what lost by preventing actions which have harmful effects (Coase 1960)<sup>40</sup>.

Because there are few situations with low transaction costs, it must be deduced that the market process (peaceful exchanges) cannot reach alone the economic optimality. The limits of the market process can be solved by the creation of organizations (private firms or governmental entities). Another means to reach the social optimal solution is the alteration of previous assignments by violent means or the criminal activity. In this way, the violation of some property rights can permit to reach the social optimum and represent

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<sup>37</sup> Friedrich von Hayek, (1991 [1953]), *Scientisme et sciences sociales*, Collection Agora, p. 163.

<sup>38</sup> Ludwig Von Mises (1990 [1920]), *Economic Calculation in the Socialist Commonwealth*, Ludwig Von Mises Institute, Auburn, Alabama.

<sup>39</sup> Ronald Coase (2000), *Le coût du droit*, Collection Droit, Economie, Société, Presses Universitaires de France, p. 94.

<sup>40</sup> Ibid. p. 28.

an alternative way to peaceful exchanges. The organized crime with private organizations, the forced redistribution of rights by the State or the partial enforcement of law represent alternative solutions for the maximization of the social welfare. According to Coase, the social arrangement, which permits the highest level of production, must be preferred. Consequently, because the positive transaction cost situations are the general cases, there is no reason that a free market constitutes the appropriate solution. Here are the connections between Coasian's analysis and the economics of crime approach, which need to be more deeply investigated.

### 3 The Coasian Analysis and the Economics of Crime

The analysis defended by the classical school of crime consists in applying the neoclassical hypothesis to the economics of crime (Carnis 2004)<sup>41</sup>. These authors (Becker, Ehrlich. . .) assume that it is possible to apply the principles of the marginal analysis to determine a social optimum and to conceptualize an equilibrium by a process of maximization that allows to reach an efficient situation (Stigler, 1970)<sup>42</sup>.

The goals of the different works of the classical school of crime are to show that the criminal obeys a system of incentives and that it is possible to determine an optimal quantity of crimes (Ehrlich, 1973)<sup>43</sup>. The criminal's behavior is then the outcome of comparable gains and costs, the tradeoff between which reflects his rationality. Because the criminal acts rationally, the authority in charge of justice and law-enforcement can provide a rational answer. This is clearly the purpose of Becker's article on the economic approach to crime (Becker, 1968)<sup>44</sup>.

The major articles on economics of crime did not quote Coase's article on the problem of social cost, although there are clearly some common points. More accurately, they

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<sup>41</sup> Laurent Carnis (2004), "Pitfalls of the Classical School of Crime", *The Quarterly Journal of Austrian Economics*, Winter, 7(4), p. 7.

<sup>42</sup> George J. Stigler (1970), "The Optimum Enforcement of Laws", *Journal of Political Economy*, May-June, (3), p. 530.

<sup>43</sup> Isaac Ehrlich (1973), "Participation in Illegitimate Activities: A Theoretical and Empirical Investigation", *Journal of Political Economy*, (81)3, p. 559.

<sup>44</sup> Gary S. Becker (1968), "Crime and Punishment: An Economic Approach", *Journal of Political Economy*, March-April, (78): 169-217.

share the same hypothesis and lead to similar recommendations<sup>45</sup>. Four points deserve particular attention: the hypothesis of maximizing production, the absence of a theory of justice, the justifications for State interventions and the importance of transaction costs as explanation of market failures.

### **The Maximization of Production**

Coase and the proponents of the classical school of crime sustain the objectives a society has to follow consist in maximizing the total available product for a given level of the factors of production. If there were no social conflict on the use of resources between the individuals, the determination of the total available product would result from an engineered program for allocating the resources among the different productive uses. The additional production or the surplus would be yielded by the difference between the total production and the costs of production. The process of allocation by the price mechanism would normally allocate the resources to the highly productive uses. Because there are some interferences between the different uses of resources, the allocation is considered as being imperfect. The price mechanism would be in default to allocate the resources towards their highest use when there is a situation of conflict. Indeed, voluntary bargaining is one possibility for the parties, but only when the individuals recognize the legitimate use of resources. It is not the case for situations with disputes. Conflict means a disagreement on the legitimate use of these resources. Consequently, these disputes represent a cost for society, which adds up to the regular costs of production. They represent losses, which diminish the available production. The goal then is to minimize the social cost of attaining the highest possible level of available production for the given factors of production<sup>46</sup>.

For instance, Becker asserts in his seminal article:

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<sup>45</sup> It is not the purpose of this paper to explain the absence of mutual quotations between both analysis. We want only to stress the similarities of these analysis.

<sup>46</sup> If we note : NP=net production, TP=total production, CP= costs of production, SC= social cost, TC=total costs of production. Then  $NP = TP - CP$  (without disputes). With disputes,  $NP' = TP - CP - SC = TP - TC$ . Then if CP is given because the available factors of production are determined, TP can be deduced and NP is easily computed. If SC is positive, there is a decrease for the available production equals to  $NP - NP' = SC$ . Consequently, whatever the program costing (S) for minimizing the costs and inferior or equal to  $\Delta SC$  (due to S), it permits to decrease TC and to increase NP'. The losses are reduced of an amount of  $(\Delta SC \text{ (due to S)} - S)$ .

The method used formulates a measure of the social loss from offenses and finds those expenditures of resources and punishments that minimize this loss (Becker 1968)<sup>47</sup>.

And further in his conclusion:

The main contribution of this essay, as I see it, is to demonstrate that optimal policies to combat illegal behavior are part of an optimal allocation of resources. (Ibid.)<sup>48</sup>

Ehrlich, too, wrote:

The approach economists have taken toward these choices has generally been based on a “public interest” criterion: the law enforcement authority seeks to maximize social welfare by minimizing the losses from crime, including the costs of law enforcement and crime control. (Ehrlich, 1996)<sup>49</sup>

According to Becker, the offences do not constitute *a priori* a net loss. For some “harmful” acts, Becker does not exclude the possibility that the marginal gain is superior to the marginal cost. In these conditions, these acts increase the total available wealth for society. However these acts have to be deterred when they represent a net loss for society (when the marginal cost is superior to the marginal gain). Then an optimal policy must be decided. Indeed, the purchase of (public and private) protection is considered as being an unproductive spending (Tullock, 1967)<sup>50</sup>. They do not increase the total output. Consequently, the fight against the criminal activities is conceived as a problem of finding the optimal allocation of these resources for protection, i.e. as a subset of the general allocation process of resources within society.

This common objective between the proponents of the analysis of crime and Coase appears obvious with the extension given to the validity of the Coase theorem for all

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<sup>47</sup> Ibid. p. 170.

<sup>48</sup> Ibid. p. 209.

<sup>49</sup> Isaac Ehrlich (1996), “Crime, Punishment, and Market for Offences”, *Journal of Economic Perspectives*, winter, (10)1, p. 50.

<sup>50</sup> Gordon Tullock (1967), “The Welfare Costs of Tariffs, Monopolies, and Theft”, *Western Economic Journal*, (V)3: 224-232.



harmful effects. Crime is considered as a harmful effect when the associated social costs are higher than social gains (Becker, 1968)<sup>51</sup>. So the Coase theorem can be applied to this kind of action.

The economic problem in all cases of harmful effects is how to maximize the value of production (Coase, 1960)<sup>52</sup>.

The concept of harm and the function relating its amount to the activity level are familiar from their many discussions of activities causing diseconomies (Becker, 1968).<sup>53</sup>

The process of maximization implies the definition of an optimal policy. It also suggests the appropriate reasoning is at the margin. The authority in charge of enforcement or of delimiting the right does not give a binary answer to solve the problem: accept the activity or forbid it. The objective is to determine the optimal level of violations, crimes or harmful effects. This is reached when the marginal gains of illegal acts equal their marginal costs.

It goes almost without saying that this problem has to be looked at in the total and at the margin (Coase, 1960)<sup>54</sup>

Further Coase asserts:

The aim of such regulation should not be to eliminate smoke pollution but rather to secure the optimum amount of smoke pollution, this being the amount which will maximize the value of production (Ibid)<sup>55</sup>.

Becker shares a similar view:

Put equivalently, although more strangely, how many offenses should be permitted and how many offenders should be unpunished? (Becker, 1968)<sup>56</sup>

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<sup>51</sup> Ibid. p. 173.

<sup>52</sup> Ibid. p. 15.

<sup>53</sup> Ibid. p. 173.

<sup>54</sup> Ibid. p. 2.

<sup>55</sup> Ibid. p. 42.

<sup>56</sup> Ibid. p. 170.

### The Absence of a Theory of Justice

Another common point to these analyses is the absence of a theory of justice. Coase establishes a distinction between the standards enacted by government and the awards made by courts (Coase, 1960)<sup>57</sup>. The legal dimension is composed of a public component (regulation) and a judicial one (awards). However, the State apparatus supported by police forces and other law-enforcement agencies enforces the law and controls indirectly the entire legal process. Then, Coase merely assumes that the enforcement of the law and most of the legislation have to be controlled by the State. In fact, the law is what the State says the Law is or what is enforced by its apparatus. He endorses clearly what Barnett named the position of legal positivism (Barnett, 1977)<sup>58</sup>.

The proponents of the classical school of crime adopt a similar position. The enforced law is never a debatable point. The law is given and the objective is to enforce it rationally and to determine the optimal policy. This can be illustrated by two quotations, which presents a similar point of view.

The goal of enforcement, let us assume, is to achieve that degree of compliance with the rule of prescribed (or proscribed) behavior that that the society believes it can afford (Stigler, 1970)<sup>59</sup>.

Instead of instituting a legal system of rights which can be modified by transactions on the market, the government may impose regulations by transactions which state what people must or must not do and which have to obeyed (Coase, 1960)<sup>60</sup>.

These theories do not present any “sound” ethical foundations for the Law. In these frameworks, the concept of legitimate property right becomes meaningless. The law is the outcome of a calculation of social engineering. From a libertarian standpoint, the enforcement of law can lead to the legalization of violation of legitimate property rights, by prohibiting peaceful acts and by accepting criminal activities (Carnis, 2002)<sup>61</sup>. This

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<sup>57</sup> Ibid. p. 17.

<sup>58</sup> Randy E. Barnett (1977), “Restitution: A New Paradigm of Criminal Justice” in *Randy E. Barnett and John Hagel III (eds.), Assessing the Criminal, Restitution, Retribution, and the Legal Process*, Ballinger Publishing Company, pp. 349-383.

<sup>59</sup> Ibid. p. 526.

<sup>60</sup> Ibid. p. 17.

<sup>61</sup> Ibid.

position implies that a social value is imputed to rape, murder and other abominable crimes. That creates some inner contradictions for such an approach<sup>62</sup>.

... Becker introduces a different limitation on punishment the “social value of the gain to offenders” from the offense. The determination of this social value is not explained, and one is entitled to doubt its usefulness as an explanatory concept: what evidence is there that society sets a positive value upon the utility derived from a murder, rape, or arson (Stigler, 1970)<sup>63</sup>.

### An Opened Door for State Hindrances

The classical school of crime considers the fight against crime is within the competence of the State. The State is conceived as a firm producing enforcement by combining labor and technology of detection and of control<sup>64</sup> (Votey and Phillips, 1972)<sup>65</sup>. Coase shares this view concerning the State as being a special firm. “The government is, in a sense, a super-firm (but of a very special kind) since it is able to influence the use of factors of production by administrative decision” (Coase, 1960)<sup>66</sup>. However, Coase’s analysis is more ambiguous because not only does it consider government interventionism as a solution to situations of market failure, but it also pays attention to the dangers of such a governmental regulation. Coase emphasizes the fact that governmental regulations can lead to and generate economic inefficiencies (Coase, 1960)<sup>67</sup>. He asserts that the tendency of policy-makers to overestimate the benefits, that regulations bring about, is even more dangerous. However by showing the market failures and the necessity of some regulations, he opens the door to an autonomous dynamic of regulation. Ikeda illustrated

<sup>62</sup> Zerbe tries to avoid this contradiction by integrating in the analysis the notion of “regard for the others”. To sum up, this concept suggests a crime is considered as such in a society if a majority considers that the act constitutes a crime. This endeavor is unsuccessful, because it is easy to conceive of a majority that considers slavery is legitimate for a minority of the population. The criteria of “regard for the others” is respected and abominable crimes can then be legally justified. Nozick developed a similar argument; see *Anarchy, State and Utopia*.

<sup>63</sup> Ibid., p. 527.

<sup>64</sup> Mises showed clearly the contradiction it implies to consider a governmental agency as behaving as a private firm. Ludwig von Mises, (1983 [1944]), *Bureaucracy*, Libertarian Press.

<sup>65</sup> Harold Votey and Llad Phillips (1972), “Police Effectiveness and the Production Function for Law Enforcement”, *Journal of Legal Studies*, (1)2: 423-436.

<sup>66</sup> Ibid. p. 17.

<sup>67</sup> Ibid. p. 18.

clearly the latter in his contribution to the dynamics of the mixed economy. Once the dynamics is engaged, it gets very quickly out of control (Ikeda, 1997)<sup>68</sup>. It seems Coase prefers legal intervention through courts and judges rather than regulations issued by the government. However, these ones are ultimately controlled by the State, because they need police and justice agencies to enforce their decisions and to make them effective. There is an obvious link of dependence between both. In fact, Coase is unable to see he provides justifications for the State regulation, although he thinks that he develops arguments against its expansion.

Moreover, the legal solution is clearly limited according to the works done by some economists interested in studying the scope of regulation and of liability. Shavell demonstrates that four determinants would explain the respective uses of liability and regulation to limit harmful effects. If the magnitude of harm is higher than the assets of the initiator of the act, regulation appears to be an appropriate solution. If the regulating authority is in possession of a better knowledge about risky activities than private parties, regulation constitutes the best solution. This would also be the case when the tort system brings about higher costs than the regulation process or when the probability that party escapes from its liability appears relatively high. In this last case, the incentives to take appropriate precautions would be diluted (Shavell, 1984)<sup>69</sup>. Concretely, the tort system implies costs of functioning, which can quickly become prohibitive, and it also has to address the same problem of holding the appropriate information. Consequently, the solution of regulation and governmental hindrances becomes evident and inescapable.

Yet, Coase tries to explain that market transactions or the firm itself can bring private solutions. He asserts also the governmental regulations can cost more than the amount of losses avoided. But this scope is so restrained by the importance of transaction costs, it reduces dramatically the number of possibilities let to private solutions. Coase stresses that all social arrangements for dealing with harmful effects have costs and that there is no reason governmental intervention should be less expensive in any specific situation (Coase, 1960)<sup>70</sup>. However, this conclusion is far from showing the superiority of the mar-

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<sup>68</sup> Stanford Ikeda (1997), *Dynamics of the Mixed Economy*, Routledge.

<sup>69</sup> Steven Shavell (1984), "Liability for Harm Versus Regulation of Safety", *Journal of Legal Studies*, June, (XIII): 357-374.

<sup>70</sup> *Ibid.* p. 18.

ket process or of a private solution. Coase only claims that the governmental regulation is not automatically the best solution.

### The Importance of Transaction Costs

Although Coase's objective is to emphasize the importance of transaction costs for the working of the economy, it is difficult to explain why he gives so much importance, roughly one third of his article, to a situation with zero transaction costs. In fact, he accepts the model of pure and perfect competition as the normative standard to understand the role of law and to explain the presence of the firm and the interventions of government. Coase deduces from the presence of high transaction costs the existence of legal institutions and regulations.

A similar point of view is shared by Posner to explain the existence of criminal law<sup>71</sup>. According to Posner, criminal law permits to promote economic efficiency by forbidding the coercive transfers of wealth when transaction costs are low. The prohibition is justified by the creation of inefficiency in the allocation of resources for such conditions. For these situations, the market transactions are the most efficient means of allocation<sup>72</sup>. The legal system permits to reduce inefficiencies by discouraging the criminal acts.

The major function of criminal law in a capitalist society is to prevent people from bypassing the system of voluntary, compensated exchange—the “market”, explicit or implicit—in situations where, because of transaction costs are low, the market is a more efficient method of allocating resources than forced exchange. (Posner, 1985, 1195)

Consequently, the prohibited acts constitute an efficient class of acts. It is easier to understand the logic of this reasoning once it is noticed that all is determined by the importance of transaction costs. The property rights are not important *per se*. They reflect only trade-offs concerning the transaction costs. Consequently when the transaction costs are very

<sup>71</sup> Richard A. Posner (1985), “An Economic Theory of the Criminal Law”, *Columbia Law Review*, October, (85)6: 1193-1231.

<sup>72</sup> Posner asserts the efficiency of market for low transaction costs must be considered as a definition. “When transaction costs are low, the market is, virtually by definition, the most efficient method of allocating resources” (Posner, 1985, p. 1195). But what does he mean for low transaction costs? What are the hypotheses of such a claim?

high, the involuntary transfers of wealth could be justified if the new user of the resource yields a net increase of production. The respect of property rights and the enforcement of law depend on the relative importance of the costs of defining and enforcing them in comparison to the costs of transaction (Alchian and Demsetz, 1973), (Demsetz, 1967)<sup>73</sup>. If the gains associated with the definition of a right are lower than its costs, the right is not awarded. If the costs of enforcement are higher than the damages done, the right is not enforced and the criminal is not suited.

The maximization of production, the absence of a theory of justice, the justification of interventionism and the importance given to the transaction costs show clearly common points between the Coasian analysis and the economic approach to crime by the mainstream economists. In fact, these theories are similar and entangled, although Coase does not deal precisely with crime and the economic approach to crime does not refer explicitly to the theorem of Coase.

#### **4 The Consequences of Coase's Analysis for Criminal Activity**

The previous part emphasized the links between both analyses: the Coasian approach and the economic approach to crime. More interesting are the consequences implied by such theories for practical recommendations. Five points will be developed in this section: the incentives for the criminal activity, the implications in terms of uncertainty for the definition of rights, the increase of legal costs for society and the dangers of the extension of governmental hindrances, and the consequences of a static approach.

##### **An Incentive for the Criminal Activity**

The Coasian analysis provides an incentive for the criminal activity. Criminal activity is defined here as being the physical violation of a legitimate property right. By determining an objective of maximization of production, the Coasian analysis focuses only on the end to be reached independent from the means used. Here, the end justifies the means. One consequence of such an approach is the meaninglessness of notions of victim and

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<sup>73</sup> A. Alchian and H Demsetz (1973), "The Property Right Paradigm", *Journal of Economic History*, (43): 16-27 ; Harold Demsetz (1967), "Toward a Theory of Property Rights", *American Economic Review*, (57): 347-359.

criminal. Indeed, the criminal can be conceived as being a hero in so far as he makes the creation of an additional wealth possible. In that respect, he represents an entrepreneur who combines available resources in a more efficient way. The victim or the person who bears the consequences of the harmful act is perceived as an obstacle to the search for efficiency. Consequently, any contestation becomes possible provided that the contestant shows a better use of the resource. If each person assumes his own use of the resource is the best one, this theory leads very quickly toward a generalized situation of criminality and favors the appearance of many disputes and conflicts.

By giving a central importance to the cost of transaction, this approach would recommend logically to prevent from spending a part of the resources for protection. Indeed, these expenditures represent a deadweight loss according to Tullock's analysis (Tullock, 1967)<sup>74</sup>. The best way to achieve this goal is logically to limit the protection of rights relative to an optimal level. Thus only optimal "crimes" will remain. These crimes are considered optimal because they yield more than they actually cost.

This position is also illustrated by the two following quotations extracted from Coase's article:

But the problem is to devise practical arrangements which will correct defects in one part of the system without causing more serious harm in other parts (Coase, 1960)<sup>75</sup>.

Pigou is, of course, quite right to describe such actions as "uncharged disservices". But he is wrong when he describes these actions as "anti-social". They may or may not be. It is necessary to weigh the harm against the good that will result. Nothing could be more "anti-social" than to oppose any action which causes any harm to anyone (Coase, 1960)<sup>76</sup>.

### **Conditional Property Rights**

The criterion of the social cost consists in comparing the different social arrangements of property rights. More accurately, the different levels of production associated with the latter are compared. The highest one determines the efficient social arrangement.

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<sup>74</sup> Ibid.

<sup>75</sup> Ibid. p. 34.

<sup>76</sup> Ibid. p. 35.

Coase is right when he says that the market transactions lead the resources towards the highest productive uses, but he is wrong when asserting this same process permits also to maximize the total available production. Indeed productive uses can yield also psychic revenue, that physical goods, and their quantity, cannot account for. In fact, it will be more correct to assert that the market transactions put the resources into the hands of the persons that value them the most.

The assimilation of productive use to production permits, however, to determine a scale for judging the efficiency of the social arrangements. By considering that the level of production is the objective to be reached, Coase imposes his own preference for determining the criteria supposedly indisputable and obvious. Consequently, the rearrangement of rights is a necessity and a logical consequence of this analysis. The delimitation and the award of rights are not definitive but dependable upon the situation practically at stance. It means a person could be entitled for six months, but could lose his right after this period if the empirical conditions evolve. Consequently, the allocation of property rights can be regularly modified. For the Coasian analysis, the permanent redefinition of property rights does not constitute a problem considering that the harmful effects present a reciprocal nature. The individuals do not hold a right but a bundle of rights, which can enter into conflict for some of them with the exercise of a bundle of rights by another person.

The cost of exercising a right (of using a factor of production) is always the loss which suffered elsewhere in consequence of the exercise of that right- the inability to cross land, to park, to build a house, to enjoy a view, to have a peace and quiet or to breathe clean air (Coase, 1960)<sup>77</sup>.

The incompatibility between the different uses implies, because of the hypothesis of the maximization of production, that the use that yields the highest level of production will be preferred. What is problematic in this approach is the manner through which the arrangement is done, namely through violent means, unlike the market process, which permits a rearrangement of the rights through peaceful and voluntary bargaining.

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<sup>77</sup> Ibid. p. 44.



### The Cost of the Legal Process

The courts are at the center of the legal re-arrangement of rights. The working of courts must face the costs of functioning. The budgetary constraint leads the authority in charge of enforcement to renounce to detect, to suit and to punish all criminals. Becker's model of crime is a perfect illustration of determining the consequences of an optimal policy of deterrence (Becker, 1968)<sup>78</sup>. Stigler asserts, "The cost limitation upon the enforcement of laws would prevent the society from forestalling, detecting, and punishing all offenders..." (Stigler, 1970)<sup>79</sup>. Ehrlich extends the hypothesis of rationality to the choice of authorities: "... offenders, potential victims, buyers of illegal goods and services, and law enforcement authorities all behave in accordance with the rules of optimizing behavior" (Ehrlich, 1996)<sup>80</sup>. Shavell makes a similar reasoning to determine an optimal punishment (Shavell, 1991)<sup>81</sup>. This dimension is neglected in the Coasian analysis where the judge's decision is obvious to some extent, and even costless. The judge is assumed to hold all required information to enounce his judgment.

Another cost associated with the functioning of courts is relative to the multiplication of legal disputes. Because everybody can appropriate whatever resources through legal disputes (damages), the awards given by courts redefine the limits of the scope between the legal and the criminal acts. The multiplication of suits will lead to an increase in the spending made by individuals for legal services, and for paying the judges and the public agents. This growing expansion of the juridical scope in all different aspects of the daily life is counterproductive. The courts become the place where the rights can be negotiated through strategic suits. The law becomes then a factor of production, which can be bought instead of being a clear rule intended to protect legitimate property rights. Instead of protecting legitimate property, the legal system represents a strong attack against justice and generates legal insecurity. This perverse effect represents a true loss, the counterpart of rent seeking activities, which have been already analyzed by

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<sup>78</sup> Ibid. p. 170.

<sup>79</sup> Ibid. p. 527.

<sup>80</sup> Ibid. p. 44.

<sup>81</sup> Steven Shavell (1991), "Specific versus General Enforcement of Law", *Journal of Political Economy*, (99)5, pp. 1088-1108.

public choice economists (Tollison and Congleton 1995)<sup>82</sup>. The legal process becomes then a means to extract money and resources.

### **The Interventions of the State**

The classical school of crime purports to define the conditions for an optimal public policy. The fight against crime is a State activity, to which a central role is given. The State defines what is law, how and at what extent it has to be enforced. The law enforcement is a public concern and the place given to the private enforcement of law is not important.

Since crime is, by definition, an externality, and the maintenance of law and order is essentially a public good, the economic literature has focused mainly on the determination of optimal means of law enforcement and crime control, rather than the basic rationale for public rather than private enforcement laws (Ehrlich, 1996)<sup>83</sup>.

The Coasian position appears more ambivalent on the State intervention. Coase gives a central role to the State for enforcing the legal decisions and the regulations it enacted. The ultimate decision is in the authority of the State. It can impose by force its decisions. However Coase emphasized the risks of legalizing nuisances (Coase, 1960)<sup>84</sup>. The State can legalize some harmful acts and crimes, if its “social” computation shows the inefficient character of the enforcement of law and order. Even more dangerous is this approach that considers it possible to define an optimal amount of rapes or murders (Zerbe 2001)<sup>85</sup>. With such an approach, theft, crime, or also slavery become acceptable if the criterion of optimality is verified. Again it is only a question of weighting social costs and gains for each specific action. The enforcement of false rights is acceptable and the violation of legitimate rights is required. Coase seems to be aware of these consequences, but he is unable to provide an answer within his framework. This is a logical consequence of his analysis. “There can be little doubt that the Welfare State is likely to bring an extension of that immunity from liability for damage, which economists have been

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<sup>82</sup> Robert D. Tollison and Roger D. Congleton (1995), *The Economic of Rent Seeking*, The International Library of Critical Writings in Economics, An Elgar Reference Collection, Elgar Edgar.

<sup>83</sup> Ibid. p. 49.

<sup>84</sup> Ibid. p. 24.

<sup>85</sup> Ibid. p. 189. More accurately, Zerbe asserts the existence of “efficient rape”.

in the habit of condemning” (Coase, 1960)<sup>86</sup>. In fact, the logic of this system leads to a paradox: the protection of criminals. “Government intervention in the economic system may lead to the protection of those responsible for harmful effects being carried too far” (Ibid.)<sup>87</sup>. In a previous section we showed that a direct consequence of the possibility to administratively redistribute rights is the increase of legal disputes. This tendency justifies *in fine* an extension of the scope for State intervention. The argument leads to a closed circle. The uncertainty yielded by this legal approach legitimizes the governmental hindrances. How can an analysis warn against the dangers of the extension of the scope of governmental hindrances and claim its intervention is non-automatic when the defended analysis provides the basis for such an expansion? This is the Coase dilemma.

### A static approach

To conclude on the implications of such an analysis, we must emphasize a major defect of the Coasian analysis. This approach suggests comparing different social arrangements. It supposes the existence of an equilibrium, and that it can be attained through a rearrangement of the initial structure of property rights. In fact, Coase suggests a static comparison with given factors of production. The institutional framework is considered in fact as endogenous. However his analysis has never dealt with dynamic consequences. This reasoning ignores the effects of incentives. Not only do some (criminal) acts, if considered legal, become an incentive for committing more crimes, but they also become an incentive to reduce the level of production. If the rights were more insecure, the people would reduce their level of production to avoid forced redistribution. In fact, supposedly a social gain could be attributed to criminal acts; this analysis does not consider the long-term effects. In the long-term, the costs will be higher and the criminal gains will yield only net losses<sup>88</sup>.

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<sup>86</sup> Ibid. p. 27.

<sup>87</sup> Ibid. p. 28.

<sup>88</sup> For an introduction to this debate, see, Fred. S. McChesney (1993), “Boxed In: Economists and Benefits from Crime”, *International Review of Law and Economics*, (13): 225-231; Jeff L. Lewin and William N. Trumbull (1993), “Neither Boxed In nor Circular: A Reply to Professor McChesney”, *International Review of Law and Economics*, (13): 232-234; Richard L. Hasen and Richard H. McAdams (1997), “The Surprisingly Complex Case Against Theft”, *International Review of Law and Economics*, (17): 367-378; Jeff L. Lewin and William N. Trumbull (1990), “The Social Value of Crime?”, *International Review of Law and Economics*, (10): 271-284.

## 5 Conclusion

This article presents a Rothbardian appraisal of the Coasian analysis. Unlike the mainstream economists, who think the Coase theorem constitutes a barrier to governmental hindrances, we emphasize on the opportunity given to State's extension by suggesting a market inability to deal with some situations. In fact, the Coasian analysis undermines the role of law. It is a direct consequence of the absence of a correct theory of justice.

Coase is right to focus on the importance of the legal dimension of conflicts. But he makes an error to assert the initial delineation of rights is unimportant. By conceptualizing the possibility to rearrange the structure of property rights, he legalizes a part of criminal activities and criminalizes peaceful exchanges. Moreover he gives the opportunity to expand the scope of State intervention with its so-called role to protect the property rights.

More problematic is the confusion established relative to the role a market must play. The market process allocates the resources to the most highly valued uses, and not to the uses yielding the highest level of product. The Coasian model assumes that people are only interested in physical things, yet the psychic dimension is the most important one. Maybe it is one divergence between the approach of subjectivism and "objectivism" for determining the value of goods. There is also a confusion between the rational decision to put some limits upon allocating resources for the enforcement of law and order and the assertion that the delineation of property rights is defined by the costs of law-enforcement. A crime will never yield a "social gain". It only destroys value by preventing from peaceful allocation. Naturally, it represents a gain for the criminal, but the user or the holder of the resource will never be the legitimate owner. All crimes cannot be avoided because of the cost of enforcement, but crime will remain a crime forever. Consequently, the choice is not between two levels of production but between two harms.

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