

# NEW PERSPECTIVES ON POLITICAL ECONOMY

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# **NEW PERSPECTIVES ON POLITICAL ECONOMY**

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# **National Defense as a Private Good: Freedom as a Positive Externality: A Reply to Newhard**

Youliy Ninov

**N**ewhard (2021) questions the practicality of the new type of national defense market suggested in Ninov (2017), where the (state)aggressors are on the demand side, and the defense companies are on the supply side. In the present article, we will first clear some misconceptions arising from the different structures of the anarcho-capitalist defense market and the newly-suggested one. Later we will show the inconsistency of the definition of „free market“ used to oppose our claim that anarcho-capitalism is not a free-market system. Then we will address the arguments that barriers to imposing compensations exist and that the efficiency of the national defense will be undermined in our system.

## **Introduction**

In Ninov (2017), we suggested a structurally new national defense market as a superior alternative to the anarcho-capitalist defense agency one (Tannehill and Tannehill (1970) and Hoppe (1999)) or the voluntary militia (Friedman (1989)). In the suggested system, the aggressor pays entirely for the respective society's defense. As a consequence, private property owners need not pay for their protection. In this way, we avoided the free-rider problem altogether and made national defense an entirely private good. Thus, freedom became a byproduct of the defense market, i.e., a positive externality.

Newhard (2021) questions our national defense market on several points. First, he expresses concerns about the proportionality of remuneration of the defense agencies and opposes our claim that the anarcho-capitalist defense market is an inherently unfree one. Second, he questions the system's viability with respect to its ability to provide deterrence and survive

prolonged periods of peace. Third, he claims that due to the altered incentives of the defense agencies, the efficiency of the national defense will be compromised.

In the following, we will first address some general issues, which arise due to the different structures of the anarcho-capitalist type of market that Newhard supports (defense agencies) and the suggested one. Later we will discuss/answer in turn all the potential problems mentioned previously. Finally, we will clear an apparent misunderstanding and ask why fundamental problems of anarcho-capitalism, as discussed in Ninov (2017), have not been addressed.

## **General comments**

The system of national defense suggested differs significantly in its structure from anarcho-capitalism. This has consequences, and in particular, that some features and terms used in anarcho-capitalism are either not applicable in the suggested system at all or have a different meaning.

One such case manifests itself in the context in which the word „deterrence“ is used. Under anarcho-capitalism, the clients of the defense companies are the private property owners. In this case, deterrence is a service the private property owners pay and receive in return. Since the defense companies expend funds/resources to accomplish this task (deterrence), they have the right to expect to be compensated for it.

Under the suggested system, the clients of the defense companies are the (state)aggressors themselves. Consequently, „deterrence“ as a service has no meaning since it is not requested by or provided to anybody. In such a situation, one can not expect to be compensated in any way for the presence of „deterrence.“ „Deterrence“ will become a byproduct of the system from which the general population will benefit. In other words, „deterrence“ will be a positive externality.

Another case in which differences in meaning and usage arise is the word „reparations.“ The present author regrets having used it because it is misleading. According to Merriam-Webster dictionary, „Reparation(s)“ means (in the particular context): „Compensation in money or materials payable by a defeated nation for damages to or expenditures sustained by another nation as a result of hostilities with the defeated nation —usually used in the plural.“ Two points need to be stressed here. First, „reparations“ relate to war between states, which however is not a market interaction at all. And second and what is more important, the usage of the word

„reparations“ subsumes an expectation that the expenses for the war must be compensated for the simple reason that they had to be done out of sheer necessity.

Keeping in mind the above, „reparations“ is easily transferred to the context of anarcho-capitalism, where companies are paid by their clients to deter the adversary. The expenses for deterrence have been made out of necessity and deserve to be compensated. In the suggested system, however, this is not the case. The expenses for soldiers, weapons, etc., have not been made out of necessity. They have been done for the standard reason why companies invest in a free market environment. Namely, they hope to make a profit and thus be compensated and overcompensated for their expenses, but without any guarantee that the latter will ever happen. When investing, companies gamble that their undertaking will be successful, but they do not expect somebody to compensate them just because they have invested some money.

Contrary to anarcho-capitalism, companies need not prove how much they have spent in the suggested system and therefore request as compensation. Their compensation in the form of resources taken from the aggressor is theoretically unlimited. Its size depends on their ability to confront and subdue the attacker. In other words, they work exactly like any other company on the free market.

Let us give an example. A libertarian society is attacked, and defense company A manages to repel the aggressor and conquer a significant amount of land, cities, industrial capacity, etc., previously belonging to the attacker. According to the laws of the specific libertarian society, some percentage of all this may be used to compensate the private property owners, who have suffered losses due to the war inflicted on them. All the rest, however, belongs to defense company A. If it decides to keep it, the courts of the libertarian society will recognize it as a new addition to the society and subject to its laws. Still, the defense company may decide that it does not wish to own all this property directly and request a regular monthly/yearly compensation from the subdued attacker instead (in this case: reparation-like) for many years to come.

Now we will answer specific objections. We will keep the same headings as in Newhard (2021) to better track the discussed problems.

## **The propriety of war reparations**

The first argument against our suggested system is that proportionality in the remuneration of the defense companies is missing (is not discussed), which is a key aspect of the Rothbardian system of justice.

Proportionality in this respect is indeed missing, and the reason is that it is simply not required due to the different structure of the system, as discussed previously (the non-present „deterrence“ service). As is typical for the free market, any particular amount of investment can bring from zero up to unlimited return in our system. Any attempt to include proportionality here would go against this standard omnipresent free-market principle.

The second argument against our suggested system is as follows. According to Newhard, a coercive market is one where the government, as an external force, distorts the interactions between the market participants by introducing taxes, regulations, etc. In other words, the government's influence leads to a deadweight loss. Similarly, non-government criminal behavior can make a market unfree only if it leads to the mentioned deadweight loss. Since no deadweight loss is present in the anarcho-capitalist defense market, it is supposedly a free market.

Note what the above-given definition presupposes. First, it presumes that the market in question exists or can exist without the particular interference (be it government or non-government one). Second, it implies (correctly) that both types of interference (again, government or non-government one ) are equal in their effect (are qualitatively the same).

The problem with the above views is that whole markets exist only and exclusively due to government interference. The prime example is the carbon-trading emissions market. It is an artificial market, which could never have existed by itself. Without being a specialist in carbon trading, the author is of the opinion that no deadweight loss is present in it. There are other similar markets, for instance, markets for different compulsory government-mandated insurances, which are artificially created and do not seem to show deadweight losses. The standard libertarian view on these markets is that they are unfree, coercive ones. However, if we apply Newhard's definition, they must be free ones. In other words, the given definition and the stated/standard libertarian views about these markets contradict each other.

Note that if we accept as given that the carbon-trading emissions market is unfree, this means that the outside interference that created it made it unfree. But since we presume that the origin of the coercive interference is not important, then non-government coercive interference can also create whole unfree markets on its own. However, the latter is precisely the case of the defense market under anarcho-capitalism. In other words, if the carbon-trading emissions market is unfree, so is the anarcho-capitalist defense market. Unless the latter is true, this would mean that the government and non-government coercive interferences are of a qualitatively

(not quantitatively) different nature, i.e., that the former can create new coercive markets, but the latter can not.

Here is the time to state our view about what the market as such is and tries to accomplish. In our view, the (free) market is an optimizing machine that helps people resolve their problems by organizing specific markets catering to their specific needs. The market tries to do the latter as efficiently as possible under the particular circumstances (whatever they are). However, due to the latter, unfree or semi-free markets may be created. Thus the market for door locks (for instance) is unfree because the credible threat of theft (i.e., initiated aggression) is present, but this does not make it ethically wrong. Without its presence, the situation would have been much worse. Its very existence improves the lives of the market participants. Until theft, as such, exists, we can not avoid the presence of such a market. A corollary from the latter: Until initiated aggression exists in the world, no market can be absolutely free. We could only talk of more or less free markets. But the freer markets would always be preferred by the people. Thus the market participants would always choose the suggested defense market to the anarcho-capitalist one.

Given the above, we can answer the third specific accusation, which Newhard makes, namely, quote: „Even in a society where the last act of violent crime was 20 years go, citizens may still arm themselves just in case. If no more violent crimes occur, who is responsible for the handgun expenditures?“. The answer is that in this case, the particular handgun market is free because it does not exist due to the external threat of initiated aggression. People may prefer to own guns to shoot targets, for defense against wild animals, or simply because they are paranoid. Since, in all these cases, no initiated aggression is present, the market will be free. What Newhard describes is an example of a previously unfree market that gets free.

## **The practicality of war reparations**

The first argument against the suggested system is that the preferred outcome for the defense forces is if they serve as an effective deterrent and that this is a problem in the suggested system. To quote Newhard: "...the measure of the success of the defense forces is how rarely they must be used" and "As an effective deterrent, anarchists defense forces cannot generate revenue under Ninov's proposal because nobody will attack and there will be nobody to impose war reparations on."

As already discussed, deterrence is not something that defense companies strive to achieve. It simply does not apply to the suggested system. A second point is that one of the distinguishing



features of the free market is that it tries to use the available capital in the most efficient way possible. Under anarcho-capitalism, when the defense companies achieve maximum „deterrence,“ their capital will stay unused. In other words, war machinery, soldiers, etc., will stay inactive. This is a complete waste of resources, which could have been used for other, more productive purposes. In contrast, our system will ensure that the quantity and quality of defense capital will always correspond to the threats and be used to the maximum possible (i.e., efficiently).

A second argument against our system is that long periods of peace may force the defense companies to go bankrupt. Two points must be made here. First, this will be well known to the company owners, and they can plan for it. Thus they may request that war reparations (from the latest war) be paid regularly to them for many years to come, or they may keep large sums of money as a buffer for such cases. Second, if wars do not happen often, the suggested system will adjust and decrease the number and size of the companies involved. In other words, the most inefficient ones will either go bust or downsize. This reaction corresponds precisely to the way how the free market works. If a service/good is not needed anymore, then it is not produced. However, if the threat of a new war arises after many years of peace, new companies will immediately appear, or the existing ones will expand.

We should note that it has never been the aim of the suggested system to win every war. The latter can never be guaranteed. Instead, the aim is to maximize the probability that the respective libertarian society will be able to defend itself and do this in the most efficient way possible.

## **Efficient military strategy**

Newhard points out that the incentives of the defense companies in the suggested system may be altered since they will try to preserve the capital of the adversary in order to profit from it, which will make them less efficient. He uses a comparison with how wars are led nowadays.

We should note that wars happen between states nowadays, but this has nothing to do with the market mechanism. The typical outcome is a partial or complete destruction of one or both sides, general impoverishment, innumerable killings, rapes, and other human rights violations. The latter happens because the states involved do not care at all about the destruction of capital they cause. Under anarcho-capitalism, this will continue to a significant extent but will absolutely not happen in the suggested system since it will render wars civilized. A distinguishing feature of the free market is that it tries to preserve the capital to the maximum possible. That is how

the free-market functions and the suggested system will accomplish it. In comparison: Under anarcho-capitalism, the defense companies will not care how much they destroy in order to accomplish their aim. Under the suggested system, the defense companies strive to win the war but with minimum damage (i.e., not at all costs).

Another point that Newhard makes is that the defense companies will have a stronger incentive to provoke wars under the suggested system, e.g., „to fabricate a Gulf of Tonkin-type incident.“ While the latter is correct, there is another point to consider, namely, that their chances to be successful will be reduced significantly and that in case they fail, they will bear the consequences in full. Nowadays, such incidents are caused by states, and the (false) assessment of the incidents to be genuine is done by the same (obviously biased) states. This will not be the case in a libertarian society. It will be the society that will decide if the incident is a genuine or false one. Yes, an error may happen, but if the incident is declared to be a non-genuine one, then the defense company in question will become a criminal and be punished severely.

Newhard discusses several times the use of weapons for mass destruction, such as atomic bombs, which is a point worth discussing. A common argument against anarcho-capitalism is that the defense companies cannot be counted upon to use the bombs responsibly. Whether or not this is correct is not our concern. However, in the suggested system, this will not be the case for sure. One can count on people/companies not to use something if it is against their interest to do so. First, atomic bombs are capital killers, and second, unless intended to be used, they represent dead capital not worth supporting. It is very unlikely that the defense companies in the suggested system will wish to possess them, but if they do (for instance, if the opponent is much stronger than them), they will keep them no longer than really necessary.

## **Concluding remarks**

The terms “anarcho-capitalism” and “voluntarism” are often used as synonyms in the relevant literature. The present author is of the opinion that the latter term (“Voluntarism”) has been misappropriated and misused since anarcho-capitalism is not inherently a free-market system. The newly-suggested system deserves much better to be named “voluntarism” since it is an entirely free-market one, whereas the original one should keep its first name only - “anarcho-capitalism.”

Newhard accuses the present author to allegedly believe that defense is a basic human right. The latter is obviously based on a misinterpretation of the following sentence: “In this way, national defense becomes a private good and the respective society’s freedom, a byproduct,

and a basic human right.” What the author has meant here is that freedom is a basic human right, not defense. The latter view can also be found in other places inside the original article.

In conclusion, we note some glaring omissions in Newhard’s article.

- There is no implicit or explicit admission of or disagreement with the fact that in our system, national defense is unquestionably a private good since free-riding does not exist by design.
- There is no comment made concerning fundamental problems of anarcho-capitalism, which we discussed, such as:
  - The built-in conflict of interests
  - The unaligned interests of the defense companies
  - The inability to properly motivate the general population

In the above, we have mentioned only the problems specific to the particular anarcho-capitalist version that Newhard supports.

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## Bio

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# On the Use of Guerrillas in Defense of Stateless Territory

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**R**othbard (1999) argues that morality and utility require a guerrilla defense of libertarian societies, an assessment shared by many libertarian thinkers. This paper reviews the literature on guerrilla warfare to consider whether guerrilla forces alone, wielding small arms and light weapons, could successfully defend anarcho-capitalist territory. Despite the romance that surrounds them, the expert consensus is that guerrilla wars are fought only out of necessity by relatively weak powers. They are protracted wars of attrition fought on one's own territory and as such are highly destructive of the defending homelands. If the enemy does not distinguish between military and civilian targets, as is likely to be the case in a war with anarchist citizen-soldiers, defeat is almost assured. Guerrillas are most effective as complements to regular forces rather than as substitutes, and a strictly guerrilla defense should be employed only as a last resort in the event of a collapse of the regular army or an inability to raise an army.

## Introduction

A major issue in anarcho-capitalist thought concerns the provision of effective national defense in a voluntary setting. Worldwide, states have monopolized national defense, raising standing armies which they fund via taxation, monetary expansion, and plunder. Often, these armies are staffed through conscription and commanded by sociopaths with imperialistic designs; the state refers to its war apparatus as "defense" only as an Orwellian euphemism. Yet most economists continue to hold that state provision of public goods such as defense is necessary because voluntary provision results in a less than efficient level of output due to free-riding. Since the nonaggression principle precludes statist methods, a growing body of literature considers whether a voluntary society can produce an effective national defense force and what form such a force would assume.

Some anarchists believe that a professional standing army is essential. However, generating a level of revenue sufficient to raise one presents a challenge in the absence of taxes and inflation. A consensus has emerged that in a voluntary society, insurance companies would be well-positioned and incentivized to provide national defense. Tannehill and Tannehill (1970) speculate that insurance companies would sell policies indemnifying clients for losses due to foreign aggression. Since they would then have a significant financial interest in reducing such losses, the fees generated from such policies could be used to provide defense services directly, or to outsource this responsibility to private defense companies. Rothbard (2006[1970]) subscribes to this view, as does Hoppe (2003) and Murphy (2010). Yet this funding mechanism may be insufficient to build an army. Since national defense is largely territorial defense, the potential for free-riding will still exist. This is especially true for large populations where coordination costs impede the arrangement of unanimous contracts, as Friedman (2014) notes. Additionally, if the anarchist society is relatively poor or has a small population, then even in the absence of free-riding no method of social organization will successfully raise a modernized, conventional army. Lastly, in a debate hosted by the Tom Woods Show, Todd Lewis challenges Robert Murphy on the notion of insurance company-provided national defense, arguing that insurance markets are fundamentally incapable of working in the manner proposed by anarchists (Woods, 2017).

Anarchists also consider the possibility that guerrillas alone could effectively defend a free society. Rothbard (1999, 24) argues that “guerrilla war would be the libertarian way to fight a war... [as well as] enormously more effective,” citing the American colonists’ victory at Concord in 1775. A guerrilla war, he writes, rests on “individual responsibility, mobility, and surprise,” is less expensive than conventional war, relies on part-time soldiers instead of professional ones, and entails “virtually no central bureaucracy or centralized confiscation of property to finance the war.”<sup>1</sup> He concludes, “Both moral principle and utility therefore require the choice of a guerrilla war” (ibid, 25). Rothbard (1999, 443) continues,

As a people’s war, [the American Revolutionary War] was victorious to the extent that guerrilla strategy and tactics were employed against the far more heavily armed and better trained British army—a strategy and tactics of protracted conflict resting precisely on mass support. The tactics of harassment, mobility, surprise, and the wearing down and cutting off of supplies finally resulted in the encirclement of the enemy... As it was, all their victories were based on guerrilla-type concepts of guerrilla war, while all the American defeats came from stubborn

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<sup>1</sup> Guerillas tend to be relatively small and decentralized paramilitary units that rely on mobility, elusiveness, and surprise (Department of the Army, 1961, 8).

insistence by such men as Washington on a conventional European type of open military confrontation.

He echoes this sentiment in Rothbard (2006, 337-338), where he writes that guerrillas must “spare civilians from harm and pinpoint their activities solely against the State apparatus and its armed forces,” relying on “voluntary methods to staff and finance their struggle.”

Rothbard is not alone. Hulsmann (2003, 395-396) argues that “[o]f all forms of military organization, [guerrilla warfare] best harmonizes with the principles of civil society” given its voluntary and decentralized organization; thus it is “particularly well-suited to prepare the advent of a purely voluntary society.” In his essay “What Must Be Done,” Hoppe (1997) endorses guerrilla warfare, and one suspects that he does not merely speak metaphorically.<sup>2</sup> Hummel (2001) extols the “volunteer militia” not only as the system of national defense most consistent with libertarian principles, but also as a more effective one than state-run militias. Friedman (2014) similarly recommends a volunteer militia whose members are responsible for their own weapons and training.

Some anarchists call for guerrillas only as complements to conventional forces.<sup>3</sup> Long (2007, 156-160) calls for a three-pronged defense: “a regular high-tech military defense ...an armed citizenry, organized into decentralized militia... [and] organized nonviolent resistance.” As he warns, heavy reliance on a militia means having to fight wars on your own territory, which Newhard (2017; 2018) also strongly advises against. Like Long, Murphy (2017, 223) foresees guerrillas, saboteurs, and propagandists emerging as “sole proprietors” to contribute to the war effort, possibly alongside regular forces, although Murphy (2018) suspects that “large standing armies [will] not be a profit-maximizing outcome... I don’t think there would be standing armies.”

Following Rothbard, libertarians often invoke the successes of guerrilla warfare in the Revolutionary War and the Civil War where pitched battles in conventional formations sometimes brought defeat to the rebels. Murphy (2017, 223) laments that guerrilla tactics were not embraced to a greater extent by the Confederacy in the Civil War. Stromberg (2003, 225-226) criticizes the Southern strategy of “offensive defense,” noting instead the success that guerrilla tactics brought to such Confederate raiders as John Hunt Morgan, John S. Mosby, William T. Anderson, and

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2 Hoppe writes, “One’s strategy must now be that of a bottom-up revolution. And instead of one battle, on a single front, a liberal-libertarian revolution will now have to involve many battles on many fronts. That is, we want guerrilla warfare rather than conventional warfare.”

3 Irregular soldiers and guerrilla tactics are often complementary, but not necessarily so. Professional soldiers can adopt guerrilla tactics, and have transitioned to this mode of warfare since the Korean War, while irregular soldiers can mimic conventional tactics, as at Lexington in 1775.

William Quantrill. He also criticizes the Confederates for taking the fight into enemy territory instead of effectively defending their homeland (ibid, 225). Hummel (1996) is likewise critical of the Southern offensive strategy. Yet libertarians need not look only to the past. Although soldiers and civilians were more evenly matched in the 18th and 19th centuries, wars in Vietnam, Afghanistan, and elsewhere demonstrate that even modern guerrillas can frustrate the greatest military powers.

There are additional practical concerns that should cause anarchists to reconsider the effectiveness of a guerrilla defense. One is the risk that a standing army could turn against the people, a concern shared by some of America's founders.<sup>4</sup> Additionally, a conventional army can be overwhelmed and annihilated, rendering guerrillas the last line of defense. Lastly, anarchists may have to rely on guerrilla tactics out of necessity if their economy is small and a modern standing army is beyond their budget constraint.<sup>5</sup> Since modern weapons require significant financial capital, an underdeveloped economy will restrict anarchists to the use of small arms and light weapons<sup>6</sup>, some of which may even have to be provided by a sponsor.

Whatever the relevant constraints, this paper analyzes the efficacy of defending stateless territory with guerilla forces alone. Despite libertarian optimism, the prospect is bleak. Guerrilla warfare necessarily rules out taking the conflict to enemy territory to spare one's own homeland from destruction and precludes achieving quick and decisive victory through massive firepower. Instead, protracted wars of physical and psychological attrition are fought at home and civilians are exposed to violent reprisals by a frustrated enemy. Guerrilla wars cause the tremendous loss of life and property at home and a precipitous decline in living standards for survivors. Guerrillas

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4 In the Virginia Declaration of Rights of June 12, 1776, George Mason writes, "standing armies, in times of peace, should be avoided, as dangerous to liberty." The matter of standing armies is discussed throughout in the Federalist Papers and the Anti-Federalist Papers; Brutus (1986 [1788], 287), thought to be the pen name of Robert Yates, writes "[t]he liberties of a people are in danger from a large standing army;" whereas James Wilson (1986 [1777], 185) observes, "I do not know a nation in the world which has not found it necessary and useful to maintain the appearance of strength in a season of the most profound tranquility... no man who regards the dignity and safety of his country can deny the necessity of a military force."

5 A conventional army is more expensive. A labor-intensive army merely requires that a large number from the population is mobilized, whereas a capital-intensive force requires stockpiling a diverse collection of weapons which may soon be obsolete (Parker, 2005b, 7). The cost of weapons rose significantly after the development of gunpowder, and "the cost of military hardware rose to such a degree that only a centralized state could afford to buy" (Parker, 2005b, 7). Additionally, the poorer the country, the more difficult absorbing the costs of modern war becomes, as was the case in WWI where France devoted twice the proportion of its budget on the war as Germany yet spent only half as much (Parker, 2005b, 8).

6 Small arms include pistols, shotguns, rifles, machine guns, submachine guns, and so on. Many are readily available in the United States in semiautomatic configurations in calibers up to .50. Light weapons include heavy machine guns, some anti-aircraft guns and mortars, grenade launchers, shoulder-launched missiles, and portable anti-tank and anti-aircraft missile systems. In guerilla operations, these are manned by relatively small units traveling in lightly armored or unarmored vehicles. As we have seen in Syria, rebel units will likely travel in pickup trucks, SUVs, and Jeeps with missiles or machine guns affixed. Cannons and howitzers would be valuable but will be more difficult to acquire, as will more robust anti-aircraft systems and radar, which will also be vulnerable to attack from conventional forces.

are most effective as complements to regular armed forces and standing alone, they have a high rate of defeat against conventional armies. Therefore, a strictly guerrilla defense should be employed only out of necessity, and guerrillas should otherwise serve only as complements to regular forces.

In the following section, I briefly summarize the theory of guerrilla tactics. In section 3 I briefly address the shortcomings of guerrilla warfare in the American Revolutionary War and Civil War. In section 4 I address the merits of guerrilla warfare in the modern era as well as the threats posed by counter-insurgency campaigns. I conclude with a discussion of the future of guerrilla warfare in section 5.

## **Guerrilla Warfare**

Guerrilla warfare originated in ancient times when small tribes of nomadic warriors relied on ambush, mobility, and dispersal in combat. Lacking the wealth to support professional soldiers, a large proportion of tribesmen participated in battle.<sup>7</sup> This continued with the emergence of agrarian societies. For example, Greek hoplites were fulltime farmers and part-time soldiers, but “turned out so regularly for battle in their phalanxes that they perfected a high degree of combat effectiveness” (Parker, 2005b, 2). Landowners provided their own armor and weapons including shin protectors, helmet, breastplate, shield, spear, and sword (ibid, 19). They could not afford to abandon their farms for long, but adopting a raiding strategy, this system sufficed due to the brevity of conflicts. Yet following the invasion and defeat of Greece by Persia, the remaining city-states of Sparta and Athens fielded professional hoplites (ibid, 25).

By the 19th century, guerrilla tactics “were seen as symptoms of inferiority, the only possible response of undeveloped societies to the overwhelming power of European armies, difficult and exhausting to deal with, but a nuisance rather than a real threat” (Townshend, 2001, 384). Nevertheless, famed military theorist Carl von Clausewitz devotes a chapter to the subject (Volksbewaffnung, “arming the people”) in his magnum opus *On War*. Clausewitz (2000[1832], 777-779) likens “people’s war” to a “slow, gradual fire,” a “nebulous vapor,” and a mist that should “form threatening clouds from which now and again a formidable flash of lightning may burst forth.” In his view, such fighters are auxiliary but vital.<sup>8</sup>

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7 The military advantages of nomads included their superior ability to survive in harsh environments, their higher proportion of population mobilization, and leadership positions accruing to those with skill and experience rather than political considerations; Their many successes against powerful empires sheds light on how the weak can defeat the strong in war (Boot, 2013, 10-11).

8 In response to an expected German invasion in WWII, Britain raised the Local Defence Volunteers, later called the Home Guard. It included 1.5 million people who for various reasons were unable to serve in the regular forces who were pro-



Guerrilla warfare inverts conventional military wisdom. Conventional armies concentrate forces to pursue a quick and decisive victory, but guerrillas disperse to avoid direct confrontation with their more powerful enemies (Townshend, 2001, 383). They adopt the tactics of ambush and sabotage, a necessarily slow and diffuse process. Guerrillas “wear down and inflict casualties upon the enemy, cause damage to supplies and utilities, and hinder and delay enemy operations” (FM 31-21, 1961, 105). They defeat the enemy through physical or psychological attrition by accumulating many small victories over time (Jones, 2001, 681).<sup>9</sup> In the early stages of a guerrilla campaign, “Activity is generally limited to information-gathering, recruiting, training, organization, and small-scale operations” (FM 31-21, 1961, 11). Guerrillas are free to conduct these operations at will, choosing the time and manner of their attacks, ranging from ambushing road columns or attacking small detachments to engaging in sabotage (Luttwak, 2001, 153).<sup>10</sup> Being of inferior strength, guerrillas direct their energy toward “small, isolated garrisons and weakly guarded supply depots and convoys... [and] unprotected logistic installations, like bridges; they can then retreat quickly and blend in with civilians” (Jones, 2001, 680). Invaders facing guerrillas must spread themselves thin by engaging in “point defense” of vulnerable, high-value assets susceptible to raids with numerous small detachments (Luttwak, 2001, 154).

Despite their weaknesses, guerrillas possess several advantages. General T.E. Lawrence “of Arabia” believed imperialist powers were “eminently defeatable” by guerrillas given appropriate

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vided by the state with armbands and surplus rifles; they supplemented their arms with private firearms and formed themselves into over 1000 battalions (MacKenzie, 2001, 411). “Military authority was gradually imposed on the force” and they were provided with better weapons and training (ibid); ultimately, their greatest impact was in freeing up 100,000 regulars by manning anti-aircraft sites. Similarly, in 1944 the Volkssturm was created as a home guard in Germany, made up of conscripted males who were not already in the Wehrmacht.

9 There are two main methods for guerrillas to impose their will on the enemy: a strategy of annihilation and a strategy of erosion. The latter targets the will of the enemy (MCDP 1, 24-25) and describes guerrilla resistance. There is a delicate balance between the concentration and dispersal of forces. Concentration allows them to focus combat power against the enemy, but exposes them to enemy fire (See MCDP-1, 10); “A guerrilla movement that puts safety first will soon wither. Its strategy must always aim to produce the enemy’s increasing overstretch, physical and moral” (Hart, 1991, 366). Aside from guerrilla tactics, the resistance movement might distribute propaganda, instigate factory slow-gos or noncooperation, gather intelligence, disable or interrupt enemy communications, sabotage railways, and impede troop movements, although these tend to carry a high toll (see Caddick-Adams, 2001, 771-772).

10 The emphasis is on “interdiction of lines of communication, key areas, industrial facilities, and military targets” (FM 31-21, 1961, 106). This is more easily attained in difficult terrain that restrict a conventional enemy (ibid, 104). Offense can entail raids and ambushes, mining and sniping. Guerrillas must maintain their momentum through continuous action since static intervals give the enemy needed rest and an opportunity to win hearts and minds (Hart 1991, 365). Dispersion is essential so that no large target is presented to the enemy. Additionally, “to best cope with the uncertainty, disorder, and fluidity of combat, command and control must be decentralized” (MCDP-1, 1997, 78). The process of target selection is determined by comparing criticality, vulnerability, accessibility, and recuperability (FM31-21, 1961, 111-114). High value targets include railroads and highways (including bridges and tunnels), waterways (including dams and electrical installations), airports, communication systems, power systems, water supply systems, and fuel supply systems (ibid, 132-137). Rather than seizing and holding terrain, guerrillas seek temporary area superiority through surprise, maneuver, and mass (ibid, 103) in attacks of short duration. Operations consist of centralized planning and decentralized execution (ibid, 108). Raids are surprise attacks on enemy assets characterized by stealth, brief violence, rapid disengagement and swift withdrawal (ibid, 114) to destroy, capture, or kill personnel.

“mobility, security, time, and doctrine” coupled with their natural advantage in intelligence gathering due to fighting at home (Townshend, 1997, 161). He argued that time was on the side of the guerillas (Townshend, 2001, 384). Some disadvantages accrue to the enemy: longer supply lines, a hostile population, vulnerability to raids, and eventual exhaustion (Stromberg, 2003, 223). Guerrillas have no permanent installations to defend and thus have greater freedom of action, as opposed to conventional forces which must defend their bases, communication lines, economic assets, government buildings, and infrastructure (Kilcullen, 2010, 8-9).<sup>11</sup> Much modern weapons technology is also well-suited for fighting a guerrilla war. According to Townshend (2001, 385), guerrilla warfare in the 20th century reveals that:

Technological development favored the guerrilla rather than the counter-insurgent forces. The whole tendency of modern weapons was to make firepower more portable. The grenade launcher, for instance, transformed the striking power of small fighting groups; plastic explosives like Semtex were a similar boon. As against these, the stupendous increase in the destructiveness of air power has been of limited utility in guerrilla war. The USA was able to inflict appalling collateral damage on Vietnam, but not to inflict a decisive check on the Vietcong.

However, guerrillas also see some disadvantages. Although mountains and forests facilitate security and surprise attacks, supply routes are hampered and key objectives are more distant (Hart, 1991, 366).<sup>12</sup> Dispersion, which undermines combat strength, is essential due to an inability to compete with the superior strength of the enemy’s large conventional formations. Larger groupings could strike against small detachments, but this also makes them more vulnerable to attack (Luttwak, 2001, 155). Guerrillas often leave valuable areas and assets unguarded (see Galula, 2006, 10). Guerrillas also require a secure base for rest and recuperation, a place for retreat, and a source for food, fuel, and ammunition so that the search for resupplies need not dominate their missions (Jones, 2001, 680-681).<sup>13</sup> It is also argued that guerrillas must have

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11 Townshend (2001, 385) cites the success of Zionist military groups that fought the British government in Palestine in the 1940s and the National Organization of Cypriot Fighters in Cyprus in the 1950s as evidence that “declining imperial regimes could be persuaded to quit by relatively small threats.”

12 Galula (2006, 23) argues that a country isolated by natural barriers like sea or desert, or hostile neighbors, is favorable to counterinsurgents; size, configuration, terrain, and climate also play a role, with mountains, swamps, and jungles more favorable for guerrillas. Longer international borders and a more dispersed population also aid the guerrilla cause (Ibid, 24). “Because they provide suitable areas for the security of operations, mountains, swamps, large forests or jungles nurture over or guerilla type resistance,” as opposed to cities or flat plains which are more conducive to underground resistance (FM 31-21, 1961).

13 Bases also provide organization and supplies and more people. In the Vietnam war, this was North Vietnam. In the war in Afghanistan it was Pakistan, where Osama bin Laden was found and assassinated in 2011. In Algeria, the FLN used Morocco and Tunisia as a rear base (Melnik, 1964, 124).

the support of the masses (Hart, 1991, 367).<sup>14</sup> Favorable public opinion is an important pillar of guerrilla warfare, one which the anarchists will presumably enjoy in their own lands.<sup>15</sup>

Perhaps their supreme weakness is that guerrillas are highly exposed to reprisals against the civilian population; “their emotional tie to the civilian population from which they derive is a potential weakness, which ruthless occupation forces can exploit in their own relational-manuever response,” leading guerrillas to refrain from assassinations, raids, ambushes, and other effective guerrilla activity (Luttwak, 2001, 153).<sup>16</sup> Their freedom of action depends on what kind of enemy they face, on whether they can rely on his self-restraint or instead face a more aggressive power that engages in violent reprisals against civilians, including the guerrillas’ friends and families. In the conflict that gave guerrilla warfare its name, resistance to French occupation in the Peninsular War resulted in massacres of Spanish and Portuguese civilians. The reprisals of German forces in World War Two rendered impotent guerrilla resistance to the German occupation in Norway, Denmark, Belgium, France, the Netherlands, and Greece (Luttwak, 2001, 153). In the Soviet invasion of Afghanistan, the Soviet army bombed nearby villages in response to insurgent attacks and rounded up and executed fighting-age men; over time, areas with insurgent activity were depopulated as civilians moved to Pakistan and Iran, eroding the guerrillas’ vital base of support (ibid, 156).<sup>17</sup>

Despite their weaknesses, irregular forces need not be a majority of the population to achieve their objectives. Only 10% of the Hutu male population over age 13—about 50,000 people—massacred up to one million Tutsis in Rwanda; similarly, irregular forces in Bosnia, Croatia, and Serbia were relatively small and few in number but terrorized a disproportionately large number of people; the Tigers were about 1000 strong with a core group of 200 men, yet may have murdered thousands and enjoyed significant plunder (Parker, 2005b, 432). The National

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14 Such protracted wars rely on tremendous national spirit to carry on (Townshend, 1997, 156). Galula (2006, 11-16) writes that prerequisites for success includes a cause that rallies popular support. Guerrillas rely on the surrounding civilian population for security and stealth and requires their support. Thus, the importance of propaganda and the routine attempts by governments to label them as terrorists. Either way the distinction between combatants and civilian is eroded, exposing the population to “formless and uncontrolled violence” (Townshend, 1997, 169).

15 Absent mass support for the movement, guerillas seem to devolve into terrorists, as with the PLO and the IRA in the 1970s. This strategy is adopted to prevent public opposition and deny information to occupying forces (Townshend, 2001, 386) including assassination of traitors and spies (Parker, 2005a, 433). Guerrilla movements that fall back on terrorism are more likely to end quickly (Connable and Libicki, 2010, 99).

16 “When each guerrilla assassination results in the execution of several innocent civilians held hostage for just that purpose; when each successful ambush is followed by the annihilation of the nearest village; and when each raid on a headquarters or depot is followed by massacres, not many guerrillas will feel free to ambush, assassinate, and raid whenever opportunity offers;” (Luttwak, 2001, 153).

17 Weaknesses of the Mujahideen included ingroup fighting, lack of unified leadership and strategic planning, limited communications and limited firepower (U.S. Army, 1989, 6).

Organization of Cypriot Fighters (EOKA) who sought to liberate Cyprus from British rule had 1,250 members at its peak but was supported by the government of Greece with arms, funding, and propaganda.<sup>18</sup> They faced 40,000 British personnel (Townshend, 2001, 385).<sup>19</sup>

Overall, guerrillas have worse than even odds of achieving victory. Over a 200-year period, the weaker actor in asymmetric conflicts were victorious only 30% of the time but won with increasing frequency over the years (Arreguin-Toft, 2001, 96). It is thus generally not advisable that a defending power rely on guerrillas alone if they have other options. Townshend (1997, 157) writes, "Irregulars could weaken but not decisively defeat a strong and determined enemy; to achieve victory they must act as auxiliaries to conventional forces." Guerrilla warfare also tends to be protracted. A brief survey by Singh and Mei (1971, 94-95) find an average length of 7.8 years, including the 22-year conflict in China from 1927-1949. That is a long time to be at the mercy of an imperialist power especially when food supplies are disrupted. Although the US has largely been free from invasion in its history, in the next section I briefly discuss the experience of Americans fighting as guerrillas.

## **The Early American Experience**

Republicanism is strongly associated with citizen-soldiers who have the right and obligation to take up arms and defend their communities and countries against foreign and domestic enemies. Largely inspired by Whig antimilitarism, citizen-soldiers gained currency in the American colonies in the wake of the Boston Massacre when public opposition to a standing army reached new heights (Callahan, 1999, 119). The militia system had already emerged in the colonies due to insufficient military support from the crown. Most able-bodied white men were obligated to serve in autonomous local units that elected their own leaders and typically ignored the orders coming down from capital cities (see Cooper, 1999). The colonies, traversed by the Appalachian Mountains and blanketed in thick forests, provided an ideal environment for these units to practice guerrilla warfare.

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18 Dach (1965, 90) calls for the securing of funds through counterfeiting, laundering, recruiting bank and postal employees to help steal funds, and raids on enemy resources. In a libertarian cause, only the last is permissible. Otherwise, there will be charity including volunteering and providing one's own weapons. The charity of rich may supply more expensive weapons, or large fees or donations. Some guerrilla groups like the Revolutionary Armed Forces of Columbia generate income from drug activity, kidnappings, and extortion, generating revenue to establish pipelines for heavy machine guns, mortars, rocket-propelled grenades, and ammunition (Rabasa and Chalk, 2001, 32-35). In Afghanistan, insurgents received support from external states like Pakistan, and drug activity involved locally grown opium poppy (Jones, 2008).

19 The Battle of Thermopylae shows what a greatly outnumbered force is capable of with discipline, strategy, and favorable terrain (see Herodotus, 2003, 487-497).

Colonial guerrilla warfare dates to the French and Indian War in which colonists mimicked Indian battle tactics (see Chiaventone, 1999, 306). In the Revolutionary War, citizen-soldiers implemented guerrilla tactics to good effect beginning with the victory at Concord. State militias engaged in “suppressing loyalist uprisings, gathering intelligence, and impeding enemy movements” (Boot, 2013, 68). The capture of Ticonderoga, the victory at Cowpens, and Greene’s campaign in the Southern states were all guerrilla achievements (Chiaventone, 1999, 306). A force of 1000 volunteer guerrillas defeated the loyalists at King’s Mountain in 1780. In British-occupied New Jersey, militiamen harassed small groups of foraging and scouting British soldiers, leading British General Sir William Howe to order his soldiers to travel in large convoys (Boot, 2013, 68-69). The British were particularly vulnerable because the guerrillas could blend in among the other colonists, hiding their rifles in the brush and shooting British or Hessian soldiers when the opportunity presented itself.<sup>20</sup> As for the continental army, General George Washington largely pursued a Fabian strategy, relying on and cooperating with the militia and even detaching regular soldiers to harass British troops alongside the militia (Boot, 2013, 69).<sup>21</sup>

According to Boot (2013, 77-78), the Revolutionary War offers several important lessons on the nature of guerrilla warfare. First, taking on a superpower imposes a heavy toll on the defenders. In this war the colonists suffered over 25,000 fatalities due to combat and disease, representing 1% of the population. On a per capita basis, this loss of life is second in American military history only to the Civil War. Second, victory depended in part on outside support—namely, France. Third, the war demonstrates the importance of guerrillas working in cooperation with a regular army. Guerrillas prevented the British Army from concentrating its forces against the continental army, and their constant harassment weakened British forces until colonial regulars could achieve a decisive victory. However, it is doubtful that guerrillas alone could have thrown off the British crown. It was the continental army that defeated the British, not timid, undisciplined militias, which served as useful auxiliaries at best. In fact, General Washington lamented the lack of discipline and poor battlefield performance of the militia, who he blamed for the loss of Manhattan and Long Island (This Day in History, 2018). As part time soldiers, the militia were unable to fully exploit the efficiency of specialization and they developed a reputation

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20 The Hessian officer, Captain Frederich von Muenchhausen wrote, “It is now very unsafe for us to travel in Jersey. The rascal peasants meet our men alone or in small unarmed groups. They have their rifles hidden in the bushes, or ditches, and the like. When they believe they are sure of success and they see one or several men belonging to our army, they shoot them in the head, then quickly hide their rifles and pretend they know nothing... Everyone in our army wishes that the rebels would do us the favor to take their chances in regular battle. We would surely defeat them” (Boot, 2013, 69).

21 Under a Fabian strategy, pitched battles and frontal assaults are avoided in favor of a war of attrition. It is a strategy of refusing battle where one evades the enemy (Hart, 1991, 14). Fabius refused to meet the superior army of Hannibal head-on, but harassed and retreated quickly, to sap their strength, buy time, and wear down the morale of the enemy (Hart, 1991, 26-27).

for fleeing the well-trained professional British soldiers (Ayres, 2018). This view is at odds with Rothbard (1999, 443) who attributes the victory in that war to guerrilla warfare. Ultimately, America gained its independence in the war, but an uneasy peace between the free states and the slave states was destined to erupt into the bloodiest war in American history.

The experience of the American Civil War further exhibits guerrilla warfare's strengths and weaknesses. In the Civil War, Confederate guerrillas successfully confounded Union troops. Stromberg (2003, 226) praises the Southern guerrillas for tying down Union troops and harassing them on horseback. Hummel (1996, 186) notes the successes of guerrillas in the Western theatre. Libertarians are right to argue that the Southern leadership was misguided to oppose guerrillas, and indeed the Union was effective in deploying guerrilla fighters against the Confederate population. However, guerrillas were most effective as complements to the regular army rather than as substitutes for one (see Newhard, 2022). The success experienced by guerrillas in the Civil War does not imply that Confederate guerrillas alone could have fought more successfully. It is a leap of faith that guerrillas alone could have defended Richmond as successfully as General Lee did for so long; or defend Nashville, Memphis, New Orleans, Vicksburg, or Atlanta; or prevent Sherman's March to the Sea.

Guerrilla warfare requires that one conduct the war on one's own territory which is extremely costly. Citizens of the South suffered starvation, confiscation, economic destruction, evictions, mass rapes, and massacres, while the North was almost entirely spared the destruction of the war (ibid). If the South had been able to take the fight to the North, their appetite for war and their support for Lincoln would not have lasted as long. Taking the fight to the North, although unsuccessful, was determined by General Lee to be his best hope for victory in the war; the Confederate economy was much smaller than the Union's, rendering a protracted war unwinnable. Instead, Lee hoped that victorious battles on Northern territory might draw Europe into the war or even strike a knockout blow to the Union (McPherson, 1999, 32). Crossing over into Maryland would also allow Lee to feed his troops there instead of in Virginia, and potentially recruit volunteers for the Army of Northern Virginia (Hattaway and Rafuse, 1999, 131). Since guerrilla warfare has evolved over time, with the technological gap between regular armies and civilians only growing over time, in the next section I modern guerrilla warfare and counterinsurgency in a modern setting.

## Modern Counterinsurgency

What is a guerrilla campaign for the anarchists will be a counterinsurgency campaign for the enemy. As summarized above, guerrilla warfare is a protracted form of war that exposes defenders to an extended hostile occupation (Jones, 2001, 688). Their endurance depends on popular support which enables concealment, movement, attainment of weapons and supplies, intelligence gathering, and conducting operations unimpeded. Therefore, defeating the guerrillas depends on denying them access to a base of popular support: insurgents are to be pinned, either reemerging into the open where they may be destroyed, or staying quiet and remaining cut off from their base (Kilcullen, 8-10). This is the essence of counter-insurgency (COIN).<sup>22</sup>

A survey by Boot (2013, 559) finds that despite an improving record since World War II, guerrillas still lose most conflicts. Since 1945, guerrillas have won 40.3% of the time, or 25.5% going back to 1775. His survey reveals that most insurgencies are long-lasting—fourteen years on average since 1945 (ibid, 564-565). Yet he also finds that the duration of the conflict is not correlated with victory and that risky strategies to achieve a quick victory usually backfire for guerrillas. Boot (2013, 566) finds that guerrillas are most effective when they have outside support providing funding, weapons, training, and a safe harbor to retreat to. He writes that of particular importance is that guerrillas fight in tandem with complementary regular forces:

This keeps a conventional army off balance. When it masses to fight main force units, it leaves its lines of communication vulnerable to guerrilla attacks. When it disperses to focus on the guerrillas, it leaves itself vulnerable to attack by the main force.

This is the strategy that we observe in the Revolutionary War, and to some extent in the American Civil War.

Libertarians who call for a strictly guerrilla defense of free societies should suspend their preoccupation with the American Civil War where the technological gap between citizen and soldier was smaller and consider what a modern conflict with a major power would look

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<sup>22</sup> COIN usually involves targeting the base area from which guerrilla supplies are drawn, inhibiting the raiding strategy through a “persistent combat strategy” of direct combat engagement and blocking communication routes and paths of retreat, and setting up fortifications in the territory (Jones, 2001, 688). COIN tactics physically isolate the insurgents from the population they rely on for concealment, supplies, and recruits through checkpoints and ID cards, and maintain control of the borders to prevent movement of people and supplies (Sepp, 2005, 10-11). With boots on the ground the invading force can attempt to establish martial law. From the US Army’s field manual on counterinsurgency, population controls include curfews, travel permits, restricted areas, ID cards, licensing for jobs, immigration restrictions, and registration of firearms and automobiles, and trade restrictions, all of which US citizens have been or are already subjected to (FM 3-24.2, 3-26).

like. The history of US interventionism yields many case studies including its conflicts in the Philippines, Vietnam, the Gulf War, Yugoslavia, Afghanistan, Iraq, and Syria, not to mention various additional paramilitary groups supported by the Central Intelligence Agency (CIA). The guerrilla wars in particular generated tremendous death tolls. Following the US annexation of the Philippines in 1899, Filipinos initially fought in conventional formations but soon adopted guerilla tactics given the ensuing heavy losses (Boot, 2013, 198). Yet despite the advantages of defending mountains and jungles, only 4,234 Americans were killed (mostly of disease), while 16,000 Filipino soldiers died fighting as did 200,000 civilians, mostly of disease (ibid, 199). These losses likely far exceed what most anarchists would consider acceptable when abandoning the relative safety of their homes in the West to forge a new civilization.

In Vietnam, the Viet Cong (VC) guerrillas and the North Vietnamese Army (NVA) regulars fought in tandem and saw some overlap in membership. Vietnam offers an ideal environment for guerrillas with its thick jungles of rubber trees concealing the ground and cu chi tunnels built below. Bamboo is plentiful and easily used for the construction of booby traps, spears, and punji sticks; the dense natural growth makes it easy to camouflage pit traps. In the daytime, peasants worked in the rice fields, but at night they picked up their weapons and attacked as guerrillas (Singh and Mei, 1971, 53). Throughout the war, the North provided a seemingly inexhaustible supply of fighters and supplies to the South along the Ho Chi Minh Trail.

The American approach to counter-insurgency in Vietnam was through massive firepower. Their planes dropped more bombs in the Vietnam War than in World War II, mostly on South Vietnam. However, noisy aircraft signaled to the VC that an attack was incoming, allowing them to slip away, and they were rarely trapped and destroyed (Boot, 2013, 418). America fought a war of attrition in Vietnam, where as Luttwak (2001, 114) puts it, "the enemy stubbornly refused to assemble in conveniently targetable mass formations (despite concentric "search and destroy" actions to induce involuntary concentrations)." Lacking the technology to detect the enemy, the US relied on intelligence and played whack-a-mole with bombings, complemented by such CIA and US special forces operations as the Phoenix Program that sought to destroy the VC through infiltration, capture, interrogation, and assassination, and Operation Wandering Soul, a psychological operation. The US also sprayed Agent Orange on 5.5 million acres of forest and farmland in South Vietnam in Operation Ranch Hand to deny the VC food and vegetation to hide in, exposing millions including US soldiers to the dangerous herbicide. Strategic bombing produced many casualties and refugees, alienating the civilian population, while the military notoriously inflated the body counts of the VC and NVA in their reports. In the end, twenty



Vietnamese die for every one US soldier killed in action. Up to two million civilians died in the war as did over one million fighters on both sides combined.<sup>23</sup>

The Gulf War began with a campaign of “aerial decapitation” to destroy air defenses. Early warning radar was destroyed and air defense systems were no longer integrated. Forty-eight hours after the air offensive began, communications were destroyed and each air force base was on its own (Luttwak, 2001, 186). Saddam Hussein could not broadcast to his subjects or communicate to his military leadership and “in Baghdad the population at large was left without electricity, telephone service, public transport, piped water, or sewer disposal” (ibid, 185). The destruction of roads and bridges impeded ability of the army to supply food, water, fuel, and ammunition to forces in Kuwait. Civilians were also killed, as “bombs rarely kill deployed troops. It is their natural dispersal that protects ground forces so well, even if not deeply dug-in, as most of the Iraqis in and near Kuwait (or the Yugoslavs in Kosovo) were not” (ibid, 193).

There was no ground campaign at all in concert with NATO’s bombing of Kosovo in 1999 (Luttwak, 2001, 199). The bombing began with symbolic attacks on air defenses, but when Slobodan Milosevic failed to capitulate, in the following month “the bombing became distinctively heavier and focused on weapon factories, depots, bases, and barracks” (Ibid, 77). Civilian targets like bridges and power stations were destroyed to undermine public support for Milosevic. NATO carried out eleven weeks of bombing in the attack on Serbia-Montenegro, “the first war victory ever won by air power alone, with no fighting whatever by ground forces” (ibid, 76).

The ongoing war on the Islamic State of Iraq and Syria (ISIS) probably sheds the most light on likely present-day military operations against an anarchist society. US airstrikes and close air support have played a significant role in the annihilation of ISIS, combined with US supplies to Kurdish Peshmerga forces and Iraqi Special Forces. US ground troops have also supplemented Kurdish forces, primarily in an advising role. In Operation Inherent Resolve, the US has carried out almost 25,000 strikes in Iraq and Syria as of August 9, 2017 (see U.S. Department of Defense, 2017). More strikes were carried out under Operation Roundup in support of Syrian Democratic Forces. The US military is also exceeding efficient at irregular warfare. In Spring 2018, the main stronghold of ISIS in Afghanistan was captured, killing 170 of them with not a single fatality among the 600 Green Berets and three companies of Afghan special forces (Fedschun, 2018). In 2006, the US implemented a counterinsurgency strategy of securing base areas of Iraqi

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23 The Tet Offensive, which failed to provoke an uprising throughout the south, achieved a political victory: the escalating violence shocked the American public and undermined support for the war (Wirtz, 2001, 907-908).

insurgents and Al-Qaeda terrorists (Parker, 2005b, 420). The strategy in Iraq and Afghanistan entailed “a rapid twenty-four-hour cycle of intelligence-led strikes, described as “counternetwork operations,” that focuses on the middle tier of planners, facilitators, and operators rather than on the most senior leaders” (Kilcullen, 2010, 4). To the West, ISIS in Syria and Iraq have been all but destroyed with air strikes and close air support. In Afghanistan, the Taliban maintained a long-term insurgency despite being outnumbered 11-1 and being outspent by a factor of 50 by COIN forces (Jones, 2012, 1). The recent history of US counterinsurgency warfare suggests numerous debilitating airstrikes and close air support for special forces on the ground, the strategy that annihilated Islamic State. Guerrillas can expect any intervention to be heavy on air strikes, yielding the inevitable collateral damage. The most effective defense in wars of this nature is a modern air force that maintains air superiority over anarchist territory.

Wars in Vietnam, Afghanistan, and Kosovo have demonstrated that guerrilla forces cannot be destroyed from the air alone (Parker, 2005a, 433). However, given the large budget, advanced weapon systems, and highly trained military personnel of the state, it is extremely unlikely that empires can be defeated or successfully repelled by the rebels as long as the state maintains full commitment to the mission. If media coverage is less of a concern, the state may adopt rules of engagement similar to those employed at the standoff at Ruby Ridge where agents were given the authority to shoot belligerents on sight whether they were armed or not. Their chief target is rebel communications (Hart, 1991, 366). This can be difficult to achieve because guerrillas do not hold fixed positions. This is the benefit of the guerrilla strategy when facing a superior enemy:

[E]nemy-focused strategy, which seeks to attack the guerrilla forces directly, risks dissipating effort in chasing insurgent groups all over the countryside, an activity that can be extremely demanding and requires enormous numbers of troops and other resources. Counterinsurgents who adopt this approach risk chasing their tails and so exhausting themselves, while doing enormous damage to the noncombatant civilian population, alienating the people and thus further strengthening their support for insurgency. (Kilcullen, 2010, 9).

Technology is less important in a guerrilla conflict, where tactics “are designed to negate the firepower advantage of conventional forces” and has seen the US and the USSR suffer defeat in guerrilla conflicts despite their nuclear arsenals (Boot, 2013, 567).<sup>24</sup>

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24 Sun-Tzu assesses the relative strength of two opposing armies on the basis of seven traits, which are: Which has popular support? Which commander is of greater ability? Which has an advantage of climate or terrain? Which army has greater discipline? Which army has superior strength? Which has better training? Which is more unwavering in its rewards and disciplines?

It is less draining on one's resources when war is concluded quickly rather than protracted over long periods. The rebel's resources will be exhausted in a protracted fight. The troops will also become demoralized. The enemy also has an interest in resolving conflict quickly but may prefer to impose a slow death instead by merely cutting off all trade routes and allowing the rebels to die of strangulation—such a strategy requires an anarchist navy to break the blockade. An extended conflict shifts the advantage to the side of greater size and resources, and the size of this advantage is proportional to the power differential. Even if the rebels are self-sufficient in food production, resources like fuel and munitions will run dry.

## **Present and Future**

This paper studies the feasibility of defending an anarchist society with irregular guerrillas. History shows that guerrilla wars are protracted and extremely costly wars that impose a significant death toll on the guerrillas and civilians alike. Industry, infrastructure, and homes are destroyed, new capital investment collapses, food shortages arise, morbidity spikes, fertility rates fall, and living standards plummet. This holds true even in victory, as exemplified by the Vietnam War. A guerrilla victory also depends on the self-restraint of the enemy, especially with respect to reprisals against civilians, but this self-restraint is often absent (e.g., the My Lai Massacre in Vietnam in 1968). A guerrilla defense is not very effective in most homeland defense scenarios as indicated by its high rate of defeat. A protracted war of attrition heavily favors larger, conventional forces who can be defeated only by losing the will to win. For these reasons, guerrilla wars are fought only out of necessity by relatively weak powers for whom professional armed forces are insufficient or nonexistent. Nations with the resources to build proper conventional armed forces invariably do so. If a future anarchist society is wealthy then it would be a mistake for them not to raise an army, especially since wealth will also make them a more attractive target. Yet libertarians often argue *ex ante*, before we can know what the anarchist economy may look like, that they should defend their society with guerrilla warfare, even if an organized conventional military is attainable. This reveals a misguided apprehension of the usefulness of guerrilla warfare. In support of my above assertions, I cite a number of scholars such as Townshend (1997, 157) who observes that irregulars can weaken but cannot

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Claims Sun-Tzu, "On the basis of this comparison, I know who will win and who will lose." In the case of a war between irregular guerrillas and a regular army, hopefully the terrain favors a guerrilla resistance and enjoys strong popular support. However, the regular arm is likely to have the advantage in the other five areas. Professional soldiers are better due to specialization. Those who possess a comparative advantage in warfare join the military. Those who do not will remain in the private sector as civilians. The tragedy of civilian resistance is that it invariably pits these relatively peaceful men and women who lack the training and proclivity for battle against those who do. There is no question that the personality traits and training that favor superior battle tactics generally belong to the members of the armed forces.

defeat a powerful enemy; Townshend (1997) and Boot (2013) who argue that guerrillas are most effective as complements to regular forces; and Boot's (2013) findings that guerrilla wars impose a heavy toll on guerrillas, last a long time, and still result in defeat most of the time.

War for the anarchist society would risk becoming a total war, requiring the mobilization of the entire population and their resources (see Bicheno, 2001, 915-916). The length of war is generally longer under a guerrilla defense, and anarchist populations which highly value production and peace may have a low tolerance for the level of death that we see in warzones today. Mao advocated a deliberately protracted guerrilla war strategy, building up a conventional force in time and eventually taking the offensive. Newhard (2017; 2018) recommends that anarchists build conventional and nuclear forces including a peacetime standing army combined with a strategic doctrine of disproportionate force to achieve quick and decisive victory when attacked. If anarchism produces rapid capital investment and growth, then a standing army should be attainable. If it resembles a modest agrarian republic, then this approach must be abandoned; the community of citizen-soldiers will be responsible for their own guerrilla defense. Since capital is attracted to regions where property rights are secure and the risk of war is low, the provision of an effective national defense force will be key is achieving a critical mass of support for any emerging anarchist society. Anarchists should thus work to develop a proper military before a credible threat emerges. The history of imperialism reveals that a mere guerrilla defense is not an effective deterrent to invasion. Anarchists must build a proper defense capable of deterring aggressors rather than a mere token defense force incapable of tackling likely invasion scenarios. Deterrence is ideal, but when it fails, wars must be quick to save lives and spare as much capital from destruction as possible. Paramount to success is the defense of land and sea trade routes that allow importation of food, fuel, and weapons, as well as exports of domestic output. The guerrilla defense is not a path to this outcome. The anarchists may also need to develop a permanent armaments industry since beating plowshares into swords in wartime, and the sentiment "When the enemy comes we fight, when he goes away we plough" (Stromberg, 1979, 45), is not workable in the twenty-first century.

Although much combat now is urban warfare, the days of large armies and battles are not over. The invasion of Kuwait was carried out by almost 1,000,000 troops, most of whom were American. The invasion of Iraq in 2003 was carried out by a coalition of 380,000 troops. Anarchists will also need to acquire or develop cutting-edge weapon systems. Murphy (2010, 59, fn. 59) claims that anarchist weapons "would be designed for defensive use," but most weapons that are useful for defense are also useful for offense. This is easy to see in small arms, but even long-range weapons

like ICBMs and SLBMs play a role in defense and, more importantly, deterrence. The United States Marine Corps concludes that “there exists no clear division between the offensive and defensive. Our theory of war should not attempt to impose one artificially” (MCDP-1, 1997, 35).

Does the fact that guerrillas armed with Kentucky rifles defeated redcoats armed with the Brown Bess musket suggest that guerrillas armed with AR-10s could defeat soldiers supported by drones, gunships, and satellite surveillance? The spread between the firepower of guerrillas and state armies grew significantly in the twentieth century and continues to diverge. There is still a role to be played by guerrillas, but only as a supplement to conventional forces. Even such necessities as rockets, antiaircraft missiles and artillery imply at a minimum a well-trained, semi-professional army, even more so for modern fighter planes or tanks. We must also consider that the morale of the soldiers is tied to the quality of their weapons and the quality of their training (du Picq, 1921, 124). Morale will be low if anarchists are defending their society against a major power with small arms alone.

In contrast with the experts who observe the rising importance of guerrilla warfare in the modern world, I fear that the era of guerrilla warfare may be waning. When the enemy has drones and satellites, helicopters that can spot the enemy in the dark or under cover of forests, energy weapons, and mechanized warriors, technology is rendering guerrilla resistance obsolete because there is nowhere to hide, and it is difficult for guerrillas to strike back. Technological improvements in weapon systems have enabled US forces to pick off their enemies in the Middle East in small groups from several miles up with Predator drones and AC-130 gunships. For most ground operations, special forces will be deployed against anarchists, similar to the ongoing US operations in Africa. Guerrillas have been influential in the past several centuries but technological advancements in warfare, most of which are beyond the reach of all but the richest governments due to their high costs, may render guerrilla resistance obsolete in the coming centuries or decades. When individual combatants can be monitored in real time from the sky and annihilated from an unseen, unmanned drone with no warning, resistance may be futile.

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# **A Case for Better Defined Property Rights and Against Air Pollution Taxes, Tariffs, and Quotas**

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**M**ost professional economists see air pollution as a sub-category of “market failure”; namely external diseconomies or negative externalities. We argue, in contradistinction, that this is on the contrary, an example of government failure, to uphold private property rights vis a vis trespassing smoke and other such particles. We summarize the debate taking place with regard to these issues as well as add material critical of the market failure hypothesis.

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## **Introduction**

Air pollution constitutes an extremely convoluted crossroad of varying interests including property rights, social welfare, “public good”, ethics, environmental justice, ecology, saving the planet, just to name a few. There have been various solutions proposed and implemented with the goal of curbing air pollution, including environmental regulations via pollution quotas, and tradeable emissions rights. Also included are the supposedly more “capitalistic” strategy of regulating profit driven incentives through taxes and tariffs on environmental pollution as well as resort to the Coase theorem. In the present paper, we argue against all of these so-called solutions. In addition, we make the case for not only more privatization but more, stronger and better-defined property rights.

The generally accepted view of environmental pollution in the economics profession is that it is a “market failure”, an economically inefficient or socially harmful misallocation of resources. This can also be called a negative externality or an external diseconomy.<sup>1</sup> The semantics are not in the least bit important. What is significant is that these terms lead to the erroneous conclusion that pollution is some sort of natural predestined byproduct of “capitalism”. As it happens pollution has much less to do with the evils of industry than it does with the absence of property rights and a competent government to enforce them.

In our view, the market failure hypothesis is problematic. But we do more than criticize it; we also summarize both sides of this debate.

## Background

In early 19th century America and Britain, prior to the onset of the industrial revolution, there were multiple cases in court where private property owners sued for pollution damages and injunctive relief. There were at the time referred to as private nuisances; also included in this category were cases in which a plaintiff’s enjoyment of his land is interfered with substantially or unreasonably.<sup>2</sup>

The courts at the time were much keener on defending property rights than they are now.<sup>3</sup> They typically awarded plaintiffs for damages and/or injunctions. While the second industrial revolution was well underway, there came an increase in actions for injunctions brought by environmental plaintiffs against their pro-developmental entrepreneur neighbors.

During the “Progressive Era”, the United States had long become less the agrarian society and more the ever-expanding imperialistic power.<sup>4</sup> There was greater demand and need for such things as steel production, machine tool manufacturing, and railroad construction. The courts progressively<sup>5</sup> shifted from a system that protected property rights of greedy individuals to a system serving the “public good” of big oil and steel corporations.<sup>6</sup> When property owning individuals sued for damages, they rarely succeeded. When these industrial pollutants violate

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1 For a critique of the notion that “externalities” are a market failure, see Barnett and Block, 2007, 2009; Block, 1983, 1990, 1992, 1993, 2003B; Cordato, 1992; Hoppe, 2003; Lewin, 1982; Rothbard, 1982; Santoriello and Block, 1996; Terrell, 1999.

2 Kurtz, 1976; Rothbard, 1982; Horwitz, 1977

3 A rare counter example is the recent Supreme Court ruling protecting private property rights against the trespass of farm labor union organizers. See on this Haynes, 2021.

4 Op cit, fn. 3

5 We mean this in both senses of this word

6 Op cit, fn. 3

private property rights, it is governmental failure to act that allows them to do so, not a failing market.<sup>7</sup>

## Thesis

The argument for pollution being a market failure is that polluters do not incur the full costs of pollution.<sup>8</sup> But it is important to recognize that the threat of lawsuit under well and clearly defined property rights makes up for that very lack of cost. When the courts neglect property rights, even the staunchest of “green” capitalists has zero incentive to run an environmentally friendly business. In fact, any such green capitalist would be at such a competitive disadvantage by incurring these costs that he would almost certainly be put out of commission.

In contrast, when the courts side with property right holders, even the staunchest anti-green capitalist has incentives to run an environmentally friendly business. If he doesn't, he will be sued for damages and issued an injunction. The anti-green capitalist will then be led by Smith's (1776) “invisible hand” to cease polluting other peoples' property rather than being sued. This entrepreneur has a few options. He can try to contain the air pollutants on his own property, for example by placing wire meshes in his smokestacks so as to “internalize the externality.”<sup>9</sup> Alternatively, the private property rights respecting capitalist will seek to export his pollutants where the risk of lawsuits is lowest, by relocating away from residential and other such highly populated areas.<sup>10</sup>

The analysis of “air pollution” also applies to pollution of anything intangible through the air, including gas pollution, noise pollution, and even light and odor pollution. This is the case because, from an economics and nuisance law perspective, there is absolutely no difference between gas, noise, and light – they're all just particles flying in the air and possibly disrupting an individual's enjoyment of someone else's private property.

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7 For the case against the charge of “market failure” see Anderson, 1998; Barnett, Block and Saliba, 2005; Block, 2001, 2002; Callahan, 2000; Cowen, 1988; DiLorenzo, 2011; Guillory, 2005; Higgs, 1995; Hoppe, 2003; MacKenzie, 2002; McCloskey, 2018; Rothbard, 1985; Simpson, 2005; Tucker, 1989; Westley, 2002; Woods, 2009A, 2009B

8 For a critique of this thesis, see Block, 1994, 1998, 2009, 2011A, 2011B, 2012; DiLorenzo, 1990; Horwitz, 1977; Lewin, 1982; McGee and Block, 1994; Rothbard, 1982

9 He need not reduce his effluent to zero. According to the legal rule of “de minimus” the law does not concern itself with trifles. If trespassing pollutants can be reduced significantly, he would no longer be vulnerable to a lawsuit. After all, we all exhale carbon dioxide, and no one is sued for so doing.

10 Assuming he moves to an uninhabited area, he can attain, via homesteading (Locke, 1689) the right to exude dust and other such particles in it.

## **The Coase Theorem**

The deeply flawed but interesting theorem argued by Ronald Coase in his 1960 article "The Problem of Social Cost" states that bargaining can solve this challenge. He developed this theory by considering the regulation of radio frequencies (Coase, 1959). This Nobel Prize winning economist proposed that, when two competing radio stations broadcast at the same frequencies and interrupt each other's broadcasts, if property rights were granted to both radio stations, then the radio station with the higher economic gain from broadcasting would have a financial incentive to pay the other radio station to cease and desist.

The circumstances that allow for this sort of efficient bargaining are that 1) property rights are clearly defined, 2) there are little to no transaction costs, 3) there are only a few affected parties, 4) there are no wealth effects.<sup>11</sup> Under these circumstances, the efficient solution will be the same regardless of who is awarded initial property rights by the court.

One serious problem with Coase's approach, as expressed by Murray N. Rothbard in his 1982 article "Law, Property Rights, and Air Pollution", is that, while who gets initial property rights is not important to the uninvolved economist, only that one party or the other is given property rights and defended, the parties involved do care about who has to pay whom. Rothbard questions the import of the radio stations, and suggests that, even though the superior radio station is properly motivated to pay the inferior radio station to not broadcast/interfere with its frequencies, the owner of the inferior radio station could put a much larger price tag on being bought out than what is realistically correspondent to the station's economic gain from broadcasting. Maybe, playing music and talking into a mic is the owner of the inferior radio station's love language and he will not give it up. Similarly, in Rothbard's example of the railroad and the farmer, if a railroad emitted dust particles onto a farmer's land, and the railroad company had property rights, and the farmer valued the rights in dispute more than did the railroad, then the farmer's love for his orchard would be a prime motivator to pay the railroad to pack up their dust particles and go away. Rothbard also criticizes the so called "efficient solution" questioning whether efficiency, even if meaningful should outweigh all other considerations.

## **An Ethical Objection to the Coase Theorem**

From an ethical perspective, the theorem paves the path towards grave injustices. According to the nonaggression principle, any initiation or threat of forceful interference with another

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11 For a dispute about this latter assumption, see Block, 1977; Demsetz, 1979; Block, 1995; Demsetz, 1997; Block, 2000

individual or his property should be illegal. If the Coase Theorem approach to forceful interference of another person's property were to be extended to the case of forceful interference with another person, the reasoning would carry across from torts to criminal actions. For example, if a man was to commit a murder, the Coase approach could resolve that, if the murderer valued the experience of killing to a greater degree than the victim valued his own life, the murder would be in service of the public good and would rightfully constitute "justice". This is highly problematic, to say the least.<sup>12</sup>

Furthermore, according to the Coase Theorem, a nuisance is not so simple a situation as party A causing damages to party B; rather, for party A to not cause damages to party B would in turn cause damages to party A.<sup>13</sup> It is rather a double-edged sword; therefore, property rights can justifiably be arbitrarily distributed. This is also problematic. For civilization to exist, we need clear and enforceable property rights rooted in something other than their subjective price values. The point is, relative prices are continually changing. On day one, the corn-beef price ratios might be such that the Coasean judge gives the nod to the farmer, not the cattleman. On day two, relative prices might have changed in such a way so that the farmer wins the dispute between the two of them. And on day three we might revert back to day 1. This is no way to run a railroad, to mix our metaphors. This is no way to maximize GDP, as Coase's theorem have matters.<sup>14</sup>

## The Homesteading Principle

The libertarian alternative to simply granting property rights arbitrarily to either party under the inconsistent pretense that the efficient solution outcomes of the two depend upon arbitrary considerations, property rights should be redefined and clarified using the ethical principles of nonaggression and homesteading. Here, the means by which a person gains ownership over a previously unowned natural resource by act of original appropriation or putting it to active

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<sup>12</sup> Block (1996) makes this point using O.J. Simpson and his wife as examples.

<sup>13</sup> For Coase (1960) a unidirectional analysis is simplistic. In his view, it is improper to say that A hit B, and thus the former is at fault. Rather, B also imposes costs on A by objecting to being hit by him. Thus was arrive at a sort of "two way street." In Coase's view, the challenge it to determine whether wealth in the GDP sense will be maximized by allowing A to hit B or to prevent this action, and all bets are on the table. That is, there is no presumption that A should be prevented from engaging in this act against B.

<sup>14</sup> For an Austro-libertarian criticism of the Coase theorem, and its public policy implications, see Barnett and Block, 2005, 2007, 2009; Block 1977, 1995, 1996, 2000, 2003A, 2006, 2010A, 2010B, 2010C, 2011; Block, Barnett and Callahan, 2005; Bylund, 2014; Cordato, 1989, 1992a, 1992b, 1997, 1998, 2000; DiLorenzo, 2014; Fox, 2007; Hoppe, 2004; Krause, 1999; Krecke, 1996; Lewin, 1982; North, 1990, 1992, 2002; Rothbard, 1998, 1997; Stringham, 2001; Stringham and White, 2004; Terrell, 1999; Wysocki, 2017.

economic use. This principle prioritizes the first person to use the land. In addition to the natural resource itself, an individual can homestead the right to pollute on his land.

This means that a factory can homestead the right to emit dust particles and an open-air concert amphitheater can homestead the right to make loud noise.<sup>15</sup> In applying these property rights, a person who moves next door to the dust emitting factory or noisy amphitheater cannot rightfully sue for private nuisance under a libertarian system with the homesteading principle. This scenario is called “moving to the nuisance”, and it is a pillar of what a future paradigm of property rights with any sort of logical consistency would be.

## **The Case Against Pollution Taxes, Tariffs, and Quotas**

While pollution taxes and quotas differ in the sense that the taxes targets “green” profit incentives and quotas are direct government regulation, the aim is the same with both: to curb pollution. There are numerous multiple arguments commonly made in criticism of both. One such is that *ceteris paribus* they disincentivize investment in industrial sectors that suffer financial losses due to these taxes and quotas, such as construction and transportation. Another is that there is a carbon leakage, or businesses transferring production to countries abroad with less policy-related constraints and costs to on air pollution.

It hardly promotes green environmentalism for U.S. and Canadian companies to open up shop in China and India, where controls are far less stringent. To this, a pro-state environmentalist might advocate for the third head of the hydra: pollution tariffs to counterbalance this maneuver and keep polluters within the reach of climate policy. Nevertheless, this does nothing to rectify the economic loss. The only outcome that a pollution tariff will have will be to block out cheaper-made imported manufactures for more expensive domestically produced “green” manufactures. All this does is transfer the net economic loss from one area to another. This is deadweight loss, or the net loss of economic efficiency and wealth when the socially optimal quantity of a good or service is not produced.

## **A Critique of Tradeable Permits**

Another government approach to air pollution control aside from regulation is the use of tradeable permits. Under this system, a government pollution control agency issues a scarce number of

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<sup>15</sup> As long as each confines the effluent to his own property, homesteaded in this manner. In other words, an airport might consist of only one square mile of physical property, but if it was the first to homestead the noise rights, it might be allowed to make noise for 10 square miles.



pollution permits authorizing the discharge of a certain amount of air pollutants. While the initial number of permits issued, as well as the certain amount of air pollutants authorized by each permit, would be determined politically<sup>16</sup> the system is designed to progressively reduce the aggregate number of pollutants. If a polluter with a permit can reduce his pollutants at a lower cost than another who has a permit, the one with a competitively advantage has an incentive to reduce his pollutants and sell his permit to the competitively disadvantaged polluter, therefore profiting from the difference between the cost of reducing pollution and the sale of the permit.

For example, suppose there are three firms, each emitting 40 tons of pollution into the air, annually, and it has been determined that only 90 tons would be optimal. One way to achieve this goal is with a quota of 30 tons each. But if firm A can reduce its emissions cheaply, while C can only do so with great expense, then the goal of 90 tons can be achieved as follows: A: 10, B: 30 and C: 50. Note, the latter actually increases its effluence, but the overall goal is still achieved. Of course, C must pay a fee to A for covering its contribution to cleaner air.

This is a more capitalistic approach than the stricter regulations of taxes or quotas and allows for much more flexibility. Furthermore, the tradeable permits policy allows for environmentalist organizations to buy up as many permits as possible, thereby lowering emissions all the more. In 1990, a tradeable permit amendment was made to the Clean Air Act,<sup>17</sup> allowing for success in lowering sulfur oxide emissions nationwide. By 1997, all 445 utility boilers and combustion turbines that were subjected to the tradeable permits policy had met their required emission standards. The utilities had reduced their emissions to 30% below the emissions cap required by the permits at a about 50% of the expected cost and acid rain had declined by over 10%.<sup>18</sup>

This system, however, is flawed (McGee and Block,1994). While tradeable permits could succeed within a specific framework with specific execution, their success is contingent on the coincidence that the cost of a firm lowering pollution is lower than the gains a firm makes by selling his permit. The ideal scenario is that it be scientifically and carefully construed so that the permits are appropriately priced according to the cost of lower pollution, but "ideal" is another term for "unlikely." Most likely, the pollution control agency would be unable to correctly deduce the costs of a polluter going green and, therefore, unable to issue permits that polluters could sell for a profit. Hence, a system of tradeable permits is unreliable, and its success is heavily contingent on coincidence and a high-value execution of policy that the government is most

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16 E.g., arbitrarily, insofar as economics is concerned

17 Environmental Protection Agency, 2020

18 Anderson, Leal

likely incapable of. But this does not mean that there no benefits to private property owners issuing tradeable permits for nuisances. More of that in the conclusion.

There are other problems. It is unclear that the government can accurately assess the total amount of pollution that is optimal. In our numerical example, it was 90 tons. But if and when the bureaucrats over or underestimate this amount, there is not market process such as bankruptcy which will automatically impose a correction. Another difficulty is that this system to closely resembles that not of laissez faire capitalism but rather of market socialism. Yugoslavia for a time imposed this system,<sup>19</sup> but it was still communism. Then there is the problem of tradeable emissions rights. If pollution onto other people's property is a trespass, there should no right to do any such thing, which can then be bought and sold. For example, there is, properly, no such thing as tradeable rape rights or tradeable murder rights or tradeable theft rights. The only "optimal" quantity of these acts is zero.<sup>20</sup>

## **Dispelling Concerns About Rothbardian Property Rights**

In a separate utilitarian exemption to the criteria of the Coase Theorem, and also in direct concern for the Rothbardian thesis of suing for pollution damages, what if there are many affected parties, as there usually are? Can a man in Montana sue a man in Florida for damages and an injunction for driving his carbon-emitting vehicle over 2,000 miles away, since the Montana man among the many (very slightly) affected parties? Taking the example of auto emissions, the Florida man should not be liable for pollution damage to the Montana man, because, aside from the fact that the causal linkage of the emissions to the damage over that far of a distance would be unreasonable for a judge to consider, there is a far more efficient solution at hand: to hold the property on which the damage is done liable for the damage. Under this system, a privately owned road<sup>21</sup> would be sued for private nuisance and run the risk of the court ruling to award the plaintiff for damages and issue an injunction.<sup>22</sup> This is costly. So, the owner of the road will begin to impose anti-pollution regulations for motor vehicles emitting carbon on his property.<sup>23</sup>

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19 Uvalic, 2018; Estrin, 1991

20 Yes, there are optimal amounts of such vicious crimes, but only in an entirely different sense. It would not be rational, for example, to devote the entire GDP to reduce any of them to zero, even if we could, which is doubtful in any case, for then we would all starve to death.

21 Block, 2009

22 Rothbard, 1982

23 In like manner, one does not sue each and every participant in an after-hours nightclub for noise pollution. One does so against the nightclub owner.

A criticism this solution might face is that this would be a public nuisance lawsuit, rather than private nuisance, even if the road is privately owned, because it affects many individuals. This is wrong. Even if the road were hypothetically public property, the damage could be considered a private nuisance. For example, in *Corning v. Lowene*, Chancellor James Kent of New York granted an injunction against the obstruction of a public road, finding that there was special damage affecting the plaintiff's enjoyment of his private property.<sup>24</sup>

Nevertheless, there are yet further hypotheticals to be raised in challenging the efficiency and transaction cost-effectiveness of the Rothbardian system. For example, what if there was a farm whose cattle's belches and flatulence contributed to the atmosphere's greenhouse effect? It is not as if there is some road where a multitude of cattle farmers' stock pass through while belching and flatulating with a specific and identifiable owner to be held responsible. The belches and flatulence are kept surrounded but, say, tens of thousands of acres of land, far and away from any third party's private property that might be disrupted. The question is no longer who the polluter is, but who will sue the polluter. In a scenario where air pollutants enter the atmosphere but directly disrupt no third party's property, their pollution may go uninterrupted. This is unless the cattle farm can be issued an injunction on grounds of public nuisance.

### **The Greenhouse Effect: The Blindspot of Privatization?**

The anti-market environmentalist might ask: How might enforceable property rights scaring away polluters from residential areas fix the problem of pollution? He might say that private property rights serve to protect private property, but not to stop pollution. The objection emanating from this quarter might be that when a polluter chooses to relocate away from residential areas in order to avoid lawsuits, rather than paying the cost of damage for containing pollutants on his own property or paying the cost of technological innovation to avoid pollution, the polluter would find himself in a tragedy of the commons situation where he can safely export his air pollutants onto neighboring public lands or forests to his heart's content, much like the situation of the elusive cattle farm. This type of environmentalist is wrong.

In truth, there are major transaction costs associated with relocating a factory, farm, or plant on the countryside far from third party property, such as transportation costs and operational opportunity costs such as a loss of employer options. If these transactions costs are to be avoided, a polluter might find it more cost-effective to be located near a more populated area

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24 Kurtz, 1976, p. 627

and eat the cost of polluting a third party. This would inadvertently lead to the polluter limiting air pollutants in order to cut costs.

There is yet another tack he could take in opposition to the public policy we are offering. The objection here might take place on the macro level: pollutants to any one person might not exceed de minimus requirements. However, the overall effects on the planet might be such that we all suffer together. He might rely on that old aphorism: "Let us hang together (cooperate with one another) or we will all hang separately (perish individually). There is nothing in libertarian that would gainsay this critique of free enterprise. Matters could take place in this manner. We involve ourselves in no logical contradiction in assuming, arguendo, that this is indeed the case. What response can be offered against this possible scenario.

We rely on the burden of proof doctrine. According to yet another ancient and venerable legal doctrine, "possession is nine-tenths of the law." The burden of proof rests with he who wishes to change the status quo. Have critics of the free enterprise system come anywhere near acquitting themselves of this obligation? No. Worse, they have not even tried. Instead, they take the stance that anyone who disagrees with them is some sort of "denier," thus substituting slurs for science. If the "sky is really falling" they need to do more, much more, to demonstrate this, than heretofore.

## **Common Law Reform**

Another promising challenge to the private property rights approach to fighting air pollution is that there are laws and practices in place that account for the high costs of suing. This is why "better defined property rights" are necessary in a system fully reliant on common law. The argument is generally that the burden of proof under common law is a main driver of unnecessarily high costs of litigation in a nuisance lawsuit. As a tort, a nuisance claim requires a preponderance of evidence as burden of proof on the plaintiff. This brings new context to the proposal by the 19th century libertarian constitutional lawyer Lysander Spooner. Spooner advocated for evidence beyond a reasonable doubt as the burden of proof on the plaintiff in civil cases, arguing that the test of guilt should not be dependent on the degree of the punishment if proven guilty and that, regardless of the degree of punishment, all defendants deserve the same protection. He said: "The lives, liberties, and properties of men are too valuable to them, and the natural presumptions are too strong in their favor to justify the destruction of them

by their fellow men on a mere balancing of probabilities, or on any ground whatever short of certainty beyond a reasonable doubt."<sup>25</sup>

Spooner was correct in his call for common law reform, though he was wrong as to the direction in which he intended to reform it. If the high costs under common law pose a threat to the economic efficiency of protecting freedom and liberty, which they do, then they, by extension, are a threat to the protection of freedom and liberty. Thus, the burden of proof in common law must be reformed in the direction of lower cost. As for beyond a reasonable doubt, there will always be some doubt. So long as there is some doubt, there is a probability that the court makes a mistake, and, so long as the court can err, it is only in favor of individual freedoms that the probability that it does be considered in correspondence to the degree of punishment attributable for offense.

Another amelioration of this difficulty is that to the extent private courts are substituted for their less efficient public counterparts, these litigation costs will be reduced. The very idea of private costs will strike some as problematic, even unrealistic. However, we do have examples of well-functioning private courts: Catholic canonical courts, Jewish Bet Din and the American Arbitration Association.<sup>26</sup>

Furthermore, there is only one hypothetical that matters. If all the land is privatized, the polluter would never find himself in a situation where he can safely export his air pollutants to neighboring lands. If all the terrain is privatized, there will be no outskirt for the polluter to use as a safe haven from the grave and ever costly risk of nuisance liability. As a result, the polluter would have no choice left but to cease and desist, unless he can contractually arrange to pay those upon whom he trespasses.

## **Conclusion**

The question of pollution is as deeply rooted in normative economics and political philosophy as it is in positive fact. Is it clear beyond a reasonable doubt that privatization and absolute property rights will always and ever promise both economic efficiency and freedom? No, this is not a matter of praxeology, of pure economic logic. Rather, it is an empirical claim. but the proposition that it at least aggregately brings about better outcomes than government intervention is pretty close to that burden of proof standard. If it was the case that the government could protect the

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25 Rothbard, 1982, 139

26 For the case in behalf of private courts see Benson, 1990, 2002; Friedman, 1979, 1989; Hoppe, 2001; Osterfeld, 1989; Peden, 1977; Rothbard, 1973A, 1973B, 1998, 1991; Stringham, 1998-1999; Tannehill and Tannehill, 1984; Woolridge, 1970

environmental catastrophe brought about by air pollution, the politicians would have already been successful in fixing the problem they themselves created by neglecting property rights to begin with.

This paper has advocated for libertarian ethics and philosophy grounded in the principles of freedom, nonaggression, and homesteading as a mode of guiding the judicial branch in its treatment of absolute property rights and the federal and state governments in their nonintervention of the question of pollution. If implemented these guiding principles would curb pollution while also allotting the people as much human liberty and economic freedom as possible without infringing on the liberties and freedoms of others.

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# Review of A Declaration and Constitution for a Free Society by Brian Simpson

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**T**housands of people have tried to present their views to the public in one comprehensive magnum opus book. Some have anchored entire schools of thought, others have become textbooks, and most have naturally been forgotten. *A Declaration and Constitution for a Free Society* is exceptional because it falls into neither of these categories. Brian P. Simpson's work stands completely apart, which is its greatest strength, but also a bit of a weakness.

## About the Book

*A Declaration and Constitution for a Free Society: Making the Declaration of Independence and U.S. Constitution Fully Consistent with the Protection of Individual Rights* by Brian P. Simpson. Published in 2021 by Lexington Books. 322 pages.

*Brian P. Simpson is professor and chair in the department of accounting, finance, and economics in the college of professional studies at National University in La Jolla, California.*

Indeed, „*A Declaration and Constitution for a Free Society*“ (Simpson, 2021) is not a magnum opus of the *Wealth of Nations* (Smith, 1776) or *Human Action* (von Mises, 1949) type. Clearly, the principles described in the book are not an attempt to describe everything the author knows about society, but rewriting the Declaration and the Constitution is a task that involves understanding society from all angles. It's not a magnum opus like Paul Samuelson's *Economics* (1948), which has become a textbook, but it would still be a great addition to some courses. And it won't be forgotten because it has embarked on a fundamental task, is readable, is not overly long given the task, and is open to a fairly wide range of opinion.

Professor Simpson has come up with the book at the best of times because it is a revolutionary time. Even the most conservative of conservatives today can see that the status quo is changing. That part of the public sphere, along with the puncturing of the dot-com bubble and the Great

Recession, has come into the public spotlight. Our problems are not just the fault of fiscal policy makers, but there is something rotten in the money state.

I write about this not by accident, but because the author, prior to this book, has described extensively in two volumes the most important of business cycle theory (Simpson, 2014A; Simpson, 2014B), which, unsurprisingly for the most part, is a monetary policy issue. I have not yet read his even older book, *Markets Don't Fail* (Simpson, 2005), but it is obvious from the title and the annotation that he is looking mainly at the fiscal side.

What Professor Simpson lacked was a way forward. He was able to identify the major problems with both public policies, but a coherent work was lacking in a powerful book. Fiscal policy, monetary policy, the business cycle, and then clear, paragraph-by-paragraph wording of the proposed changes. And now he has it. What happens to some of us is that, after explaining a particular problem, we are asked how we think we should ideally proceed. Professor Simpson has a clear answer. It is a 300-page answer, which is not too small for a TV debate, but it is a digestible morsel for academics and the general public. On the other hand, it is not possible to describe the solution on one page, because we are not talking about small problems. We are talking about how to build a freer, happier, richer and all-round better society.

It is difficult to be a critic of a text with which I agree. However, it is a well-known fact within the classical liberal movement that it is those who differ only minimally in their views who argue the most. Fans of Murray Rothbard argue with supporters of F. A. Hayek, those who can't think of a name for Ayn Rand, others consider Nozick an idol, some prefer Smithian ideals, in short, what looks like a monolith from the outside is composed of hundreds of different currents on the inside.

It is easy to predict that Simpson's book will receive its greatest criticism from those who differ in only the smallest details of his view of the rebuilding of the Declaration and the Constitution.

The book clearly has a philosophical foundation built more on the ideas of Ayn Rand, though even among fans of that line of thought there would be sharp disagreements in some chapters, typically over same-sex marriage, for example. Ayn Rand is quoted from seven works in the book, while Ludwig von Mises is quoted in one, and surprisingly not a single reference belongs to F. A. Hayek.

This is particularly odd because Hayek was broadly speaking trying to come up with his *Constitution of Liberty* (Hayek, 1960), which incidentally would have been a title that would



have suited Brian Simpson's book much better. Hayek himself later admits that *Constitution of Liberty* would have been a much better title for his work *Law, Legislation and Liberty* (Hayek, 1979), which this book fundamentally lacks. Perhaps it is the typically American setting of the book's origins and subject matter, but the book lacks a discussion of the great questions of social justice, as the greats like Hayek, Rawls, and Nozick were able to do.

But this is exactly where we get into a situation where we are faulting an otherwise great work not from the opposite position, but from a very close one. This is not without merit, however, because such a discussion would make the book's themes and conclusions more accessible to readers with opposing views. In this, Hayek was so strong that he not only entered, but was even appreciated by the mainstream. Maybe not always as a whole, but that accessibility is something he excelled at.

But Brian Simpson's book, on the other hand, from the very first moment, right from the cover, clearly radiates an ideological conviction that leaves little room for further interpretation. This can be both good and bad. It is good if it is a book aimed at the already convinced who are just looking for practical guidance in one particular area. And that's my case as well. I read the book in a couple of evenings, and as an economist, I learned a lot about American context, but as a fan of the free society, I agreed with the views and just saw the book as a manual. Great manual. When someone asks me exactly how I would proceed in the case of the United States of America if I wanted a freer society, I have no doubt that this book would be among the first to come to mind. But I'm not sure it would meet with understanding. Perhaps it would at least be positive to let people know that within the broader movement for a free society we do have such a manual. That it's not just about ideas of unbridled anarchy or criticism of all things state, but also about a clear process for reviewing the most important documents.

A number of European documents also deserve revision, and Professor Simpson's book is an interesting guide to how to go about this. For the American context, there is no better way to show that we can have a freer society even on the basis of the good old documents that the Founding Fathers used to try to protect the people from politicians. They didn't succeed in everything, and at a critical time, it's a great time to wonder if we've strayed from the original ideal. If so, then the first step should be to open this book.

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## **Bio**

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# Secessionism in Northern Italy: From Constitutional Failure to Modern Crisis

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**I**n the wake of the Italian debt crisis and the Euro crisis, Northern secessionist voices have been grumbling over the costs of inter-regional fiscal redistribution – but without action. The roots of discontent run deep. The Italian founding of 1861 was forced from above, as centralization quashed local voices. The Fascist disaster and the post-world-war two republic continued the problem, with two complications: a redistributive state that uses Northern taxes to buy votes in the South; and an incomplete decentralization that added to the center’s weight, fueling resentment in the Northern economic engines. Secession is rare – even with Italy’s recent economic crisis and other secessionist movements within the European Unions, we continue to see grumbling but no action. The cost of staying is high, but the cost of leaving appears to be higher... but that calculus may change with the next crisis.

## Acknowledgment

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## Introduction<sup>1</sup>

In other work (Wenzel 2015), I have reviewed the constitutional roots of Italy’s political instability. Italy has had 59 prime ministers, presiding over 67 different governments, since 1946 – for an average governmental longevity of approximately one year. The current government is again a

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<sup>1</sup> The background material for this paper draws heavily from Wenzel 2015.

technocracy, which stepped in to stabilize democratic politics. Italy ranks 47 out of 165 countries in economic freedom, and scores a dismal 53% on the Transparency International index.<sup>2</sup> The country suffers from economic mismanagement (the debt/GDP ratio stands at 156%, up from 120% at the height of the Euro crisis a decade ago).<sup>3</sup>

Amidst these worries, the rich and efficient Northern regions frequently grumble about secession. In many ways there is nothing new under the Tuscan sun. The Italian unification of 1861 has been described as a „band-aid“ slapped on through electoral trickery and brute force to extend the power of the Piedmontese monarchy, under a veneer of liberalism and national sovereignty. Italy was imposed on the Italians of various kingdoms and duchies through an invasive centralized administrative bureaucracy that quashed local voices and traditions. Fascism nestled comfortably within this administrative structure. The bureaucracy carried on after World War Two. The North (minus Piedmont) has resented the whole thing since 1861.

This paper examines the constitutional roots of contemporary Italian secessionist movements. Section one outlines Italian constitutional history. Section two reviews the Italian sickness in a constitutional context. Section three examines secessionist grumblings in the Italian North (Lombardy and Veneto). The final section concludes.

## **Italian Constitutional History**

Italy is a recent invention, dating to the second half of the 19th century. For 1400 years after the fall of Rome in 476 there was no Italy. Before unification, the Italian peninsula comprised a half dozen independent states – with the Kingdom of Piedmont and Sardinia in the North, the Papal States in the center, the Kingdom of Naples and Sicily the South, and several duchies in between.

Sabetti (2000, 30) outlines two key phases in the century-long process of unification: first, a process of nationalist awakening and liberalism, lasting from the Napoleonic occupation until 1848. This first phase was marked by an emphasis on uniting Italy under its own national sovereignty (against Napoleon’s occupation, but also Austria’s). The second phase of the Italian founding lasted from the 1848 collapse of federalist ideas until the 1861 proclamation of a „Kingdom of Italy.“ The new country, under Piedmontese rule, saw a decade-long process of annexation, culminating in the confiscation of the Papal States and the incorporation of greater

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2 [www.freetheworld.org](http://www.freetheworld.org); <https://www.transparency.org/en/cpi/2020/index/aut>; both accessed 28 March 2022.

3 [statista.com/statistics/1203805/estimated-government-debt-to-gdp-in-italy/](https://www.statista.com/statistics/1203805/estimated-government-debt-to-gdp-in-italy/) (accessed 28 March 2022).

Rome into the kingdom. By 1861, the federalist flavor of the first phase had been snuffed out in favor of bureaucratic-administrative centralization.

From 1870 until 1947, Italy continued as a kingdom. Fascism merely adopted most of the founding regime's institutions (most notably the centralized, bureaucratic national administration).

After World War Two and the fall of Fascism, Italy became a republic. From the beginning, that republic has been marked by instability and clientelism. Italy has had 59 prime ministers, presiding over 67 different governments, since 1946. Clientelism has taken the form of a massive North-to-South redistribution scheme and an overall public finance crisis. Attempts to devolve power to the regions were postponed until the 1970s, when Italy engaged in a process of *pro forma* decentralization. That process was incomplete and not a real movement towards federalism; it amounted to a dissemination of central power to the local level, rather than a true decentralization of power.

## **Constitutional Culture and a Pathology of Italian Woes**

In Wenzel (2015), I explained the constitutional roots of Italy's political instability. I summarize that argument here, with emphasis on Northern discontent and three Italian political pathologies: ineffective constitutional constraints, formalistic rule of law, and pseudo-regionalism.

### **Ineffective Constitutional Constraints**

Constitutional success must involve matching between the constitutional parchment and the underlying constitutional culture.<sup>4</sup> Constitutional adoption can be classified into four categories, based on the origin of the ideas contained in the constitution and the origin of the constitution-making effort: (1) Foreign Source, Domestic Ideas; (2) Foreign Source, Foreign Ideas; (3) Domestic Source, Domestic Ideas; (4) Domestic Source, Foreign Ideas (Boettke et al. 2008; see also Wenzel 2017). A constitution cannot force reform; in fact, there is great danger in imposing reforms – whether from foreign or domestic sources – that do not match indigenous ideas. The source of constitutional adoption is ultimately secondary; what ultimately matters is the congruence between the constitutional text and the indigenous. This is where Italy failed,

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<sup>4</sup> For details on constitutional culture and matching, see Franklin and Baun(1995, Boettke et al. 2008, or Wenzel 2010a, 2014, and 2017; see also Hardin 1988 and 1999, and North et al. 2009. For case studies, see Wenzel 2010b and 2010c. For deeper roots in political economy, see (1) the Austrian knowledge problem (Hayek 1937, 1945 and 1960, or Read 1958); Public Choice theory (Buchanan and Tullock 1962, or Olson 1971); and (3) a synthesis of both (Bastiat 2012[1850], Ikeda 2003, or Leeson and Subrick 2006).

ab initio. Along many dimensions, Italy's first constitution failed to stick. As far as the non-Piedmontese provinces were concerned, it was a foreign imposition of foreign ideas.

Before unification, there was no Italy, and no sense of Italy. Italy was a divided nation through the late 19th century (Gold 2003, 14); „in purely historical terms, it would be better to talk not of three Italys [(North, Center and South)] but of three hundred“ Ginsborg (2003, 3). Rather than a culturally homogeneous Italy, ripe for political unification, the peninsula was divided into provinces with their own local institutions and traditions. The kingdoms and provinces had a tradition of local autonomy (Sabetti 2000, 72) and all (except, of course for the King of Piedmont) were anti-nationalist (Sabetti 2000, 40). Even the South – contrary to 19th-century rhetoric and 20th century explanations – enjoyed a rich civic culture and tradition of self-governance before unification (Sabetti 2000, 48, 216-217). The Northern provinces, which had enjoyed decentralized structures before unity, were not pleased to be annexed into the new kingdom, or to lose local autonomy and republican traditions (Gold 2003, 15, 18). In the three decades following the 1861 unification, the central government routinely ignored bills put forward by local governments or proposals that would have given more autonomy to local governments (Gold 2003, 20).<sup>5</sup>

Early intellectual proponents of Italian unification had argued that independence from foreign rule was the priority, and political unity of the peninsula was the method to achieve this. Institutional details could be dealt with later (Hearder 2001, 165; see also Sabetti 2000, 34). Centralization was imposed on the new kingdom as a response to fears of national disintegration (Leonardo et al. 1981).<sup>6</sup> The process of national unification was a „gradual aggrandizement of the Kingdom of Sardinia and Piedmont“ (Albert et al. 1894), as „the Northwest region of Piedmont (Kingdom of Sardinia) united what is now known as Italy through a process of diplomacy, coercion, and war“ (Gold 2003, 13). Parliamentary monarchy was assigned the task of unifying the country (Sabetti 2000, 10). It did so through centralization of power, to overcome regional differences (Ginsborg 2003, 145). Although the imposition took place under a liberal veneer, it „was done in an authoritarian manner“ with no respect for local traditions and institutions (Gold 2003,

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5 I note that there were indeed federalist voices between 1815 and 1861, but they were ultimately quashed (see the writings of Carlo Cattaneo and Francesco Ferrara on federalism and Italy's fundamentally polycentric political nature; Gold 2003, 3). Several federalist proposals were advanced, then rejected, in the years leading up to unification. Instead of federalism, a centralized bureaucratic system was imposed by Piedmont on the other provinces that were annexed, conquered or incorporated into the new kingdom.

6 Whether Piedmontese imposition of national unity was a genuine response to a fear of foreign domination, the result of weak institutional capacity in the annexed states (Ziblatt 2006), or the seizing of an obvious Public Choice opportunity, is another story.

16). Order was imposed from above, out of fear that local self-governance would weaken the national state (Sabetti 2000, 227). Gold (2003, 17) concludes that „Piedmont’s further extension of the Napoleonic system [of centralized bureaucratic administration] only added to the image of unification as a foreign imposition from above.“ Central bureaucratic administration was only strengthened throughout Fascism (Gold 2003, 35).

There was hope in 1948, with the end of fascism, and the return to republicanism and democracy. Alas, a constitution must simultaneously *enable* a state to do productive things, while restraining it from engaging in mischief. To quote James Madison in the Federalist #51:

In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

The Italian constitution of 1948 failed along both dimensions: it did not sufficiently empower the state, nor did it sufficiently control it. The document suffered from „ambiguity and excessive length“ (Adams and Barile 1953), and did not resolve the fundamental Italian pathologies.

### **Italy’s Formalistic Rule of Law (*Stato di Diritto*)**

A particular trait of Italian jurisprudence exacerbates the problems of centralization and redistribution. *Stato di diritto* is essentially procedural rule of law, devoid of any normative content beyond uniform application of the law. It is rule by law, rather than rule of law (Sabetti 2000, 245).<sup>7</sup> While the intent of applying the law universally and without favor may have been laudable, the result ended up being more bureaucracy and more central power.

Sabetti (2000, 89) explains the rationale for Italy’s *stato di diritto* over respect for local autonomy or discretion:

Local government institutions were not designed to be responsive to the preferences of diverse communities of people. Serving the needs of localized or private interests was regarded as perverse or as the „first step to corruption“ of the *stato di diritto*. For private citizens to take a serious interest in public affairs or local problems was regarded as improper and even illegal... according to the

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<sup>7</sup> Cf. Hayek’s (1960) requirements for *substantive* rule of law.

doctrine of *stato di diritto* only officials were presumed to be concerned with public affairs or local problems.

This led to a number of economic and political consequences (see Sabetti 2000, 244-245 for details; generally, see Hayek 1937 and 1945). Italy's *stato di diritto* helps to explain the continuity of the Italian state, through three regimes (parliamentary monarchy, Fascism, and democratic republic).<sup>8</sup> While the electorate changed and the politicians changed, the underlying bureaucracy steamed on. Sabetti (2000, 48) explains that Italy's liberal unifiers naively believed that a national bureaucracy was a neutral device – as long as it was in the proper hands, all would be well.

In more contemporary terms, we have a Public Choice story of regulatory capture (see Stigler 1971, McChesney 1987, Carpenter and Moss 2014). Thus, the very same system could be used to unify the country and „make Italians“ under the parliamentary monarchy, to shape people in the image of imperial Rome under Fascism, to advance republican values – or a corporatist and redistributive state – under the republic (Sabetti 2000, 90). Ginsborg (2003, 394) concludes that the Italian welfare state, which burgeoned in the 1970s (after three decades of state-driven industrial development, which also was used to curry favor with the electorate), was both inefficient *and* a vehicle for party power.

### **Pseudo-Regionalism**

The 1948 constitution attempted to provide some regional counterweights to the central power, as a safeguard against the abuses of Fascism. There were even secessionist pressures in some of the regions that had a long tradition of independence or ethnic minorities; five of those (Sicily, Sardinia, Aosta, Friuli-Venezia Giulia, and Trentino-Alto Adige) were granted special status, if not federal autonomy, under the constitution. But, overall, the constitution paid only lip service to regionalism; the regions remained „nothing more than a simple designation on paper,“ as enabling legislation was blocked for two decades.

By the 1970s, regionalization was attempted, but the process was incomplete. The regions did not correspond with historical entities, but they were engineered from the top down (del Duca and del Duca 2006). The process added layers of complication to the national and local administration (Posner 1977; Sabetti 2008, 108). Del Duca and Del Duca (2006) explain that the process was one of top-down regionalism, where the national state maintained primacy over regions – both in administrative/constitutional law and in manpower, as the national

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<sup>8</sup> We are reminded here of Tocqueville (2021[1856]) and de Jouvenel (1945) on the continuity of power.



government employs two million bureaucrats, whereas the combined regions employ a mere 90,000. Gold (2003, 50) bluntly opines that „the regions have simply become an extension of central government power, and do not constitute a true separate unit of power as do the states in the United States“ – especially because there is no fiscal federalism (ibid, 51) and the regions mostly spend funds that are taxed and appropriated by the national government. The division of services among local, regional and central governments is basically decided for the convenience of the national bureaucracy.<sup>9</sup> Gold (2003, 17) reminds us that the general trend in Italy has been one of *deconcentration* of power, rather than actual decentralization, ultimately expanding the reach of the central government through additional layers of bureaucracy. In summary, „proposals to decentralize central...government authority [were like] attempts to shorten the handle of a hammer when the hammer of central bureaucracy itself was the problem“ (Sabetti 2000, 115).

## **Secessionist Grumbings**

Taken together, these Italian pathologies have caused national instability. But they also amount to regional imbalances, at the expense of the Northern provinces (Lombardy, Veneto, and Friuli-Venezia Giulia).<sup>10</sup> Gold (2003, 7) summarizes the sources of Northern secessionism in Italy: first, the crisis of the centralized state; second, the growth of the Northern states, which have become Italy's economic engine; and third, the patronage politics of postwar Italian political parties, through which the South became a vote bank for the Center, funded by the North.

The founding dissatisfaction continued with the post-war republic, as the Italian state emerged as an apparatus of regional redistribution. By and large, these goods were taken from the North and exchanged for votes in the South. While the 1970s regionalization could have been a harbinger of autonomy and fiscal rectification, the process was hopelessly broken. Besides, the camps had different goals: „the Southern regions wanted help, whereas the Northerners wanted to be left alone“ (Leonardi et al. 1981).

I offer a review of Northern secessionism from the 1970s through the 1990s. Then I discuss the resurgence of secessionism surrounding the Italian public finance crisis (nestled within the bigger Eurocrisis) and the EU „umbrella of regions.“

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<sup>9</sup> See Sabetti (2003, 87-88); see also Karpowicz 2012, Ginsborg (2003, 327), Leonardi et al. (1981) and Del Duca and Del Duca (2006).

<sup>10</sup> One might ask why Piedmont, the heart of Italian industry, is not included in the secessionist movements. First, Piedmont spearheaded unification and centralization, and its leaders imposed their will on the rest of the country. Second, Piedmont's industry attracted large Southern immigration after World War II – to the point that, by the 1960s, its capital Turin was the “third Southern city” of Italy (Ginsborg 2003, 220).

## **Secessionism from the 1970s to the 1990s**

Amidst the process of decentralization, there emerged in the North the first regional party, the Liga Veneta, which tapped into a long history of Venetian independence (see Gordon 1999). The Liga sought special status for the Veneto region and recognition of the local dialect as a separate language. The party fizzled out by 1987, but sparked regionalism (as opposed to mere decentralization) as a national question, especially in neighboring Lombardy (Gold 2003, 79-81). The Lega Lombarda was formed in 1982, drawing its name and logo from a 1176 Lombard league against the Holy Roman Empire. Like its Venetian counterpart, the Lega Lombarda sought regional autonomy – but also made secessionist noises. Unlike the Venetian movement, the Lega Lombarda was driven primarily by economics, rather than culture, and was more concerned with public finance and local governance (Gold 2003, 81-82). „Most interesting, Lombards were defined not in terms of ethnic or blood ties, but rather anyone who resided in the region for at least five years“ (Gold 2003, 82). The Lega claimed a Northern culture of entrepreneurship against national bureaucracy and Southern dependence (ibid, 82). Umberto Bossi, the leader of the Lega, contrasted the „paternalistic and clientelistic capital of Rome“ with the „capital of the economy“ in Milan (ibid, 83).

In 1990, the Lega Lombarda won 19% of votes in the regional election, making it the second largest party in the country. In 1991, the Northern leagues merged into the Lega Nord, an umbrella of Northern regional parties that ably tapped into regional and national dissatisfaction with Italian institutions, especially in the wake of corruption scandals that led to the dissolution of Italy’s two major political parties (Gold 2003, 89-91). The 1990s were the heyday of the Lega Nord, with a successful fight against a national minimum tax in 1993, and success in Milan’s mayoral race (Gold 2003, 94-95). In 1994, the Lega Nord obtained a plurality of seats in the national Parliament, and joined the ruling coalition (Gold 2003, 101). That coalition lasted a mere nine months, and the Lega was not particularly active in pushing federalism or secession (Gold 2003, 102). Gold (2003, 125) cites three reasons for this: first, minor movement toward federalism in Italy, through somewhat strengthened regions, stole some of the Lega’s thunder; second, the Lega was co-opted into national party politics; and third, the Lega was involved in its own corruption scandals. In subsequent years, the Lega Nord drifted away from secessionism towards nationalist populism (ibid, 126).<sup>11</sup>

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<sup>11</sup> In December 2016, your author saw a Lega Nord political stand in the Marches (hardly Northern Italy, and hardly a bastion of secessionism). Italian friends explained that the party was moving from its secessionist roots into a more general nationalist party.

## The Euro Crisis: A New Dawn of Secessionism

After twenty years of decline, secessionist sentiment in the North resurfaced during the Italian debt crisis (within the overall Euro crisis) in the late naughts and early teens. In November 2012, the Veneto Regional Council passed a resolution to move towards a referendum on regional independence. A referendum was set for October 28, 2013, but the question was returned to committee by the Regional Council three weeks before the election. In 1997 a mock „referendum on secession“ had garnered 90% support throughout the Northeast (Gold 2003, 107); as of January 2013, 56.7% of polled Venetians favored independence.<sup>12</sup> A parallel movement sought to have Lombardy's Regional Council pass a similar resolution. To date, no referendum has taken place.<sup>13</sup> But there has been a reinvigorated movement towards Northern independence. Why the resurgence?

First, the European Union has provided a transnational umbrella, under which regions are increasingly expressing themselves and seeking greater autonomy. The EU Committee of the Regions was founded in 1994, as „the voice of regions and cities in the European Union.“<sup>14</sup> In fact, the framers of Veneto's resolution, when calling for a referendum on regional independence, specifically cited the aspiration of regional self-determination in other European regions:

WHEREAS...

11) initiatives defending, exercising and acting upon people's right of self-determination have been:

a) already implemented recently in Scotland and Wales with the use of the referendum consultation in their respective populations for the creation of autonomous parliaments and, in 2014, the Scotland vote on a referendum to know the will of the Scots regarding the declaration of independence from the United Kingdom;

b) already advocated by other European nations such as the Catalan whose parliament has approved a specific „Resolution“, on December 18th, 1989, which solemnly reaffirms the right of the „Catalan people“ on the exercise of that right...

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12 <http://indipendenzaveneta.net/latest-poll-56-7-of-venetians-want-independence/> (accessed 28 March 2022)

13 And a referendum is not a guarantee of secession (cf. the case of Catalonia, whose Parliament voted for independence, only to have the resolution overturned by the Spanish Supreme Court, with arrest warrants issued for local leaders).

14 [www.cor.europa.eu](http://www.cor.europa.eu) (accessed 29 March 2022); see also Gold (2003, 5).

15 <http://indipendenzaveneta.net/wp-content/uploads/2013/01/RESOLUTION-44.pdf> (accessed 28 March 2022)

What is more, in this era of globalization, some theorists argue that the Westphalian nation-state may be losing some of its relevance (see Ohmae 1995 generally, or Loughlin 1996 on federalization and regionalism under the EU umbrella). Moving from theory to business, the „Four Motors of Europe“ lobby, which represents economic dynamos Catalonia, Baden-Württemberg, Lombardy and Rhône-Alpes, has shed national ties in favor of economic and commercial affinities.

Second, the Eurocrisis (along with the associated Italian debt crisis) exacerbated the discontent of the wealthier Northern regions with Italy's patronage politics and devil-may-care public finance. Indeed, Lombardy and Veneto, the two regions with the strongest secessionist impetus are also Italy's wealthiest. Lombardy, the country's most productive region, produces 22% of Italy's GDP, and its GDP per capita is one third higher than the national average. Veneto, the country's third richest region, produces 10% of Italian GDP, and its GDP per capita is 25% higher than the national average. Not surprisingly, these regions are also at the heart of Italy's regional fiscal deficit, wherein the national state transfers tax revenue from the country's seven wealthiest (Northern) regions to the eight (Southern) poorest.<sup>16</sup> Between 2000 and 2006, Lombardy was first among the Italian regions in fiscal deficit, with €3,275 per person (or roughly 12% of its regional GDP per capita) transferred to the South; Veneto was #3 in the same period, with an average of €2,600 per person (or roughly 10% of its GDP per capita).<sup>17</sup> Italy's economy has been stabilized since the Euro crisis (although COVID-19 represented, and still represents, a serious threat to the economy). But the Eurocrisis is far from finished (see Spigarelli and Wenzel 2016).<sup>18</sup>

## Conclusion

The future of Italy remains uncertain. Italy has been rather resilient over the past 70 years, since its modern foundation in the ashes of Fascism and World War Two. In spite of widespread clientelism and pervasive political instability, Italy remains solidly amongst the G8 club of advanced industrial economies, and does not suffer civil unrest to accompany political instability. Italy weathered the Eurocrisis, but public finance and politics remain volatile. The „Draghi put“ on the Euro cannot last forever (especially since Mario Draghi has left the ECB to become Prime Minister of Italy). The Eurozone may very well implode. If that happens, Italy could face soaring bond yields as it attempts to service an increasingly unmanageable debt.

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<sup>16</sup> For details on inter-regional disparities, see Vecchi 2017.

<sup>17</sup> [http://fin.vlaanderen.be/nlapps/data/docattachments/7\\_Veneto\\_RobertoCiambetti.pdf](http://fin.vlaanderen.be/nlapps/data/docattachments/7_Veneto_RobertoCiambetti.pdf) (accessed 28 March 2022)

<sup>18</sup> On the „calculus of consent,“ generally, see Buchanan and Tullock 1962; see also Sobel 1994 on the effects that redistribution of power and changing perceived benefits have on the sustainability of associations.

What is more, the financial benefits of national unity are concentrated on the South, and the costs are concentrated on the North. Public Choice theory predicts that such a policy is both inefficient and unsustainable (as opposed to an inefficient but sustainable policy of concentrated benefits and diffuse costs). The question then, is, how long Italy's forced unity can remain. Young (1976, 460-504) reminds us that „secession is a highly improbable outcome.“ Dion (1996) further tempers this assessment, by pointing out that

secession... has been particularly rare in democracies if we consider the well-established ones, that is, those with at least ten consecutive years of universal suffrage. The cases most often mentioned happened only a few years after the introduction or significant expansion of universal suffrage.

Hechter (1992) reminds us that „most of the new states formed in the [early 1990s] have been the products of fragmentation [of a country] rather than secession.“ What is more, history provides very few examples of peaceful secession or fragmentation: Hungary and Austria in 1867, Norway and Sweden in 1905, Iceland and Denmark in 1918, Singapore and Malaysia in 1965, or the Czech Republic and Slovakia in 1992. Indeed, most polities seem to have internalized Thomas Jefferson's wisdom, from the U.S. Declaration of Independence:

Prudence, indeed, will dictate that governments long established should not be changed for light and transient causes; and accordingly all experience hath shown that mankind are more disposed to suffer, while evils are sufferable, than to right themselves by abolishing the forms to which they are accustomed. But when a long train of abuses and usurpations, pursuing invariably the same object evinces a design to reduce them under absolute despotism, it is their right, it is their duty, to throw off such government, and to provide new guards for their future security.

What then, are the prospects for Italian secession? The Italian constitution does grant special autonomy to five regions (articles 5 and 116), but also plainly states that the republic is „one and indivisible“ (article 5), so we should expect as much support for Northern secession from Rome as Catalonia has received from Madrid. Dion (1996) offers a model based on fear inspired by union versus confidence inspired by secession, concluding in the mid-1990s that „the Lombard League's secessionism is certainly more rooted in confidence and less in fear...“ But „it is not enough for the Lombard League to stress the capacities of Northern Italy. They have to warn against what they see as alarming contamination of the South's inefficient and immoral practices.“ In other words, Northern Italian secessionists two decades ago were in a situation

of high confidence inspired by secession, and low fear inspired by union, making secession unlikely. That still appears still to be the case (for now).<sup>19</sup>

The cost of secession is high, but the time may come when Northern Italy moves to a situation of high confidence and high fear, if the Eurozone cannot weather the next crisis, if other countries follow Brexit, or if Italy continues with reckless public finance, while moving resources from the productive North to the dependent South. Students of constitutional political economy would do well to watch Veneto and Lombardy – as well as Catalonia and Scotland.

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<sup>19</sup> See also Hechter (1992), who proposes a model to predict the likelihood of secession, based on degree of group identification, degree of collective action, and secessionist support in the host state.

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# Accumulated Savings, Rate of Interest and Rate of Profit in a Free Market Economy

Youliy Ninov

**T**he existence of a macroeconomic fund of accumulated savings in an economy will be justified. It will be shown how this fund can repetitively be used for investment purposes. The rate of interest will be defined as the return on that part of the accumulated savings that has been lent. It will be shown why this rate is a dependent variable, directly determined by the rate of profit and how both rates are not and can not be the same. The rate of profit itself will be directly related to the structure of the economy chosen by the economic agents.

## Introduction

In the present article, we intend to discuss the determinants of the rate of interest in a closed free-market economy with a fixed monetary supply. For that purpose, we will first show how accumulated savings exist at the microeconomic level and later switch to the macro level and define a macro-economic fund of accumulated savings. We will show how the latter fund is self-sustaining and used for investment repetitively, thus avoiding constant net saving on the part of the economic agents. The places where accumulated savings reside will be discussed, and we will define the rate of interest as the return on that part of the accumulated savings that has been lent. Later, we will show how the interest rate is a time-dependent variable, which contradicts the most widely accepted Austrian economics theory of interest, namely the pure time preference theory. Once we have accomplished the above, we will derive the relation between the rate of profit and rate of interest based on a simple economic model of how banks work in a closed free-market economy under a fixed monetary supply. With its help, we will show that it is the rate of profit that determines the rate of interest, i.e., that the rate of interest by itself is a dependent variable, and how both rates are not the same thing, in particular how the rate of profit can exist without rate of interest to be defined. We will justify the existence of profit simply with the wish of the businessmen to be compensated for their efforts. Finally, we

will show how the structure of the economy directly determines profits and salaries and how the change of this structure due to net-saving/dis-saving determines the rate of profit and, from there, the rate of interest.

## **Accumulated monetary savings in an economy**

There are two main views in the Austrian economics theory concerning the rate of interest. According to the first one, for an economy to grow, the rate of interest must go down (Rothbard (2009, pp.524), Mises (1966)). For the latter to happen, the economic agents are supposed to save a growing percentage of their income/profits over time. According to the second view, the rate of interest can stay the same with the growth of the economy, but the economic agents are still required to regularly save some fixed percentage of their income/profits (Garrison 2002). The latter is easily seen when one realizes that, according to Garrison, an economy can grow when investment is in excess of capital depreciation. But since depreciation is viewed as a regularly occurring economic drain on investment, and savings finance the investment itself, then depreciation is a drain on savings too. Thus, to keep the investment stable in monetary terms, we have to add new savings constantly.

In this way, both views require that net saving be present. In the first case, net saving must constantly grow in monetary terms, and in the second, it can stay the same in time. The presence of net saving, according to these views, is necessary for compensating and overcompensating the capital depreciation of the economy so that economic growth becomes possible.

Both standard Austrian economics views on the relation between the rate of interest and saving in the economy can be described with the „leaky bucket“ analogy. Since depreciation is supposedly a drain on the economic capital (i.e., the bucket leaks), we have to constantly create new capital by saving in order to compensate for the loss (i.e., we have to continually fill the bucket so that the quantity of water in it does not decrease).

The problem with this view is that savings not only do not „leak out“ but accumulate. Let us first look at the process from a micro-economic point of view. An economic agent saves a fixed amount of money and loans it directly to another party. The receiver of the loan uses it for some purpose (e.g., to invest) and returns the same amount of money and some interest to the original saver. Note that the original agent can loan it again once the money has been paid out in full. He need not save anymore and is even at liberty to consume the interest on his loan. What is still important to realize is that the original saver would never loan his money if he expected that less money would be returned to him. If this were not the case, he would

prefer to hoard it (e.g., put it in a safe deposit box). Note, however, what happened: what was saved stayed in existence, at least until the original saver does not decide to consume it. There are three phases in the overall process described. First, the original saver saves in the strict sense, i.e., he abstains from consuming. Then this money is loaned to and spent by the receiving agent. The latter action can be likened to the process of dis-saving but is not precisely the same since the money did not belong to the receiving agent. Moreover, this money is used for buying/investing in general economic resources, not for consumption goods only. We can call the latter process wide-sense dis-saving. Later the money (plus interest) is returned to the original saver. This action is similar to saving but again is not the same since the intention to consume in the future is missing. Consumption is restricted but in the interest of the original saver, and some general economic resources are released. Similar to the previous case, we can call this process wide-sense saving. From a general point of view, the whole process above can roughly be described as saving followed by dis-saving and saving again. What happened under the surface was an act of strict saving, followed by an act of wide-sense dis-saving and later by a wide-sense saving one. The same money is being used and returned and is still available to be loaned. It did not decrease or disappear. From an economic point of view, the resources that this money commands (corresponds to) are still free/available for investment. Again: what was saved stayed in existence, and if the original saver saves more, these savings will be accumulated and be available for investment forever. As we can see, no „leaky bucket“ effect is present from a micro-economic point of view.

If we add all of the accumulated micro-savings, we can talk of accumulated savings at the macro-level. This is the total amount of the already accumulated (micro)savings in the economy, i.e., the sum of all individual savings which are already present (which stay in existence, as described previously). Since every single piece of (micro)savings does not decrease by itself (no „leaky bucket“ effect), then the accumulated (macro)savings will not go down too. The sum of non-decreasing positive elements is a positive, non-decreasing value. In this way, we established that every economy has an amount of accumulated money (macroeconomic savings), which exists and therefore can be repetitively invested and re-invested forever. Moreover, we also see no „leaky bucket“ effect at the macro level.

With the above in mind, we can understand what we meant in Ninov (2020) when we said that an economy could grow without net saving. Described in macroeconomic terms: people and companies can save on the macro-level (e.g., people save for retirement), but others can dis-save (e.g., retirees draw down their savings accounts). These two values can be equal, and

then net saving on the macro-economic level will be zero. However, we will still have a fund of accumulated savings that exists. Note that it is the accumulated savings that will be invested and re-invested. Loans will be taken and paid back, but the overall accumulated savings in the economy will stay the same in monetary terms. Net investment can be present without net-saving being present. The latter will be possible due to the existence of the wide-sense dis-saving and saving processes we discussed, which run under the surface of the economy and thus perpetuate the investment process. The investment itself will be determined not by the net saving but by the quantity of accumulated savings.

Let us take a look at the big picture. In every economy, there is an amount of accumulated monetary savings used for investment. A part of the monetary supply has been reserved (in the sense of used exclusively) for investment. The accumulated money commands some capital resources in the economy, so we see how a part of the real resources in an economy is reserved for growth. One can draw an analogy with the existence of economic profit in an economy with a fixed monetary supply. Profit can exist in it by itself (we need not artificially add money to the economy) since a part of the monetary supply is used exclusively for this purpose.

Now, when we see the big picture, we can come back to depreciation again. No monetary savings are used to compensate for it, contrary to the standard Austrian views. Depreciation is a regularly occurring economic cost, and as such, it is automatically compensated in every economy. Another part of the economy's monetary supply (and consequently another part of its real resources) is reserved exclusively for capital depreciation compensation. However, this is not the same part that is used for investment. The reader is again referred to Ninov (2020) and Ninov(2021). From this point of view, it is justified for us to use only the (standardized) term „net investment,“ which by definition is gross investment minus the depreciation. The (already standardized) term „gross investment,“ however, has no meaning in our framework since it adds two disparate types of funds: savings (for net investment) and costs (depreciation). The above describes an existing terminological problem.

Let us now again summarize our view about how the fund of accumulated savings and depreciation are related. All accumulated savings (including the most recent net saving/dis-saving act) are used for investment (net). No accumulated savings are used for depreciation compensation since depreciation by itself is an economic cost.

We described and justified the existence of a fund of accumulated savings, which is present in a growing economy. However, we did not explain „where it hides,“ so to say.

The first and most obvious place is the banking system (remember, we discuss an economy with a fixed monetary supply). Each bank possesses an amount of monetary capital, which it lends and relents constantly. This capital does not decrease. Banks do the latter by lending at such a rate of interest and by choosing their clients in such a way as to compensate their losses on some deals with higher profits on others. They are in the business of „averaging“ over their clients and over time so that they do not lose money and generate a profit for themselves.

The second prominent place is the issuing of corporate bonds (and stocks). The interest on such bonds is such that it can compensate on average the risk incurred by the bond investors. Thus in a free market, the corporate bond market value is expected to be a more or less constant amount of money in time, i.e., a permanently existing source of investment.

The third and not so prominent place is the money saved and invested directly by the companies. This process does not significantly differ from the one we described earlier when an economic agent lends his saved money to another one, and later the money is returned to him with interest. In this case, the company „lends“ the money to itself and later „pays it back“ to itself. What is left after the money is „paid back“ is the profit on the investment (interest in the previous case). Thus, the money for further investment will again be available since it will stay in existence once it is saved. When we add over all the companies, which invest their own funds, we will find a more or less constant amount of money in time, present for investment purposes. Note that the above shows how a single company need not constantly save in order to invest. It can simply reserve some of its existing capital funds for investment purposes and invest and re-invest them repetitively.

These are the three main places where our accumulated savings fund „hides.“ Still, this list is probably not exhaustive.

## **Rate of interest in a free market economy**

Once we have dealt with the accumulated savings in an economy, we will turn to the rate of interest as a general phenomenon pertaining to the whole economy. We view the rate of interest in the following way: In every economy, there is some quantity of free resources (accumulated savings) that can be used for investment purposes. Some of these resources are directly invested when companies use their own savings. The money that commands these resources is not lent but directly used. The rest of the free resources is passed to other companies for investment, i.e., the other part of the accumulated savings is lent out against interest. And it is the return on these lent-out savings (in monetary terms) that determines the rate of interest. The correct

definition of interest is the return on the lent-out capital. Capital, which is not being lent but directly invested, can earn no interest. What it earns is profit. Note that we described previously three general places where the accumulated savings reside. In this sense, the rate of interest is formed over/determined by the quantity of bank capital and the quantity of bonds/stocks only. In other words, interest is formed over a part of the available free resources (accumulated savings) and, in particular, over the ones that are being lent out. It is useful here to draw a comparison with the standard loanable funds model. In it, interest is formed over all savings, but in our model, it is formed only over the ones that are being lent out since we recognize that a part of the savings is not lent but directly invested. Thus we draw a distinguishing line between the rate of interest and rate of profit.

In our opinion, one can talk of a general (economy-wide) interest rate only in monetary terms. The reason for the latter is that it is money that allows the comparison of different heterogeneous goods or services. Money is the „common denominator,“ so to say. Without money, i.e., in a barter economy, there can be local/specific rates for separate branches/parts of the economy; however, these interest rates cannot interact with one another and form a common (economy-wide) one.

If we presume a closed free-market economy with a fixed monetary supply, then the rate of (natural) interest must be visible at the money market. Note that there is a risk component of the rate of interest, which is added to the basic (natural) interest rate. This component, however, does not change the basic interest rate. When averaging over all loans given and over time, the risk component disappears. In mathematical terms, the expected value of the risk component is zero. Thus we will discuss only the risk-free component of the interest rate.

In this simple setup, it is straightforward to observe the determinants of the rate of interest. The accumulated money is determined not by the saving rate itself, i.e., not by what percentage of our income we save in a particular time period, but by its accumulation over time. What matters is what we have saved since the process of saving itself has started. That means that the current rate of interest is not determined only by our recent willingness to save or dis-save but mainly/ predominantly by our previous, i.e., past, decisions. Our current saving decisions affect the rate of interest only to a small degree since we presume that the amount of money accumulated in the economy is significantly more than the one added/saved in the present period (e.g., in a year).

The above-given explanation, which looks trivial and obvious, leads to certain conclusions about the predominant interest rate theory in the Austrian economics school, i.e., the Pure Time Preference Theory (PTPT). In particular, it leads to the conclusion that it is incapable of describing the rate of interest phenomenon. The reason for that is straightforward: PTPT claims that the interest rate is determined by the discount of future goods with respect to present goods. However, the discussed discount is presumed to be determined only by the economic agents' present time preferences. The previous/older time preferences of the economic agents are not taken into consideration. What matters in PTPT is the net saving/dis-saving [e.g., Rothbard (2009), pp.388], which is a flow variable that pertains only to the present. In reality, however, it is the amount of accumulated savings (inclusive of the most recent act of net saving/dis-saving) that determines the interest rate, i.e., it is the stock variable (accumulated savings) that matters. To generalize the problem: The rate of interest is a time-dependent variable. Its value in each new time period depends on its value in the previous one. PTPT is a time-independent theory, however. It presupposes that the interest rate value does not depend on the previous time period. Thus PTPT is fundamentally incompatible with the real economic processes that determine the rate of interest and therefore cannot be used to describe them.

The above-described problems stem, in our opinion, from how the process of saving is viewed in contemporary Austrian texts. Each act of net saving is supposedly lost forever once it is invested since net saving and economic growth are inextricably linked. In reality, however, and as we know very well from our everyday life, each bank loan given to a company for investment must be paid back. Consequently, the money from the paid-back loan can be re-invested again later. Moreover, this money can also be accumulated over subsequent time periods from the net saving/dis-saving of the economic agents. Thus the physical resources used for investment are being returned and re-used for further investment. They do not simply become unavailable for investment as implicitly presumed. Net saving is not a prerequisite for net investment, in fact (Ninov (2020)).

## **Rate of interest vs. rate of profit in a free market economy**

As discussed previously, we can imagine a simplified economic model of a closed free-market economy with a fixed monetary supply. In such an economy, the rate of interest can be observed directly, and this will be the rate at which the free capital in the economy is lent. We wish to find out what the determinants of the rate of interest are.



Let us imagine a bank with equity capital **C<sub>e</sub>**, which is not being lent, and base capital **C<sub>l</sub>**, which is being lent. We will denote the interest rate with **IR** and the profit rate with **PR**. Let us now describe the relation between profit and interest rates for this bank. Assuming *I* is the money received as interest/income, we can write for the rate of profit:

$$PR = \frac{I}{C_e + C_l}$$

So, the rate of profit is the income divided by the overall capital of the bank.

We can, however, represent this formula differently by rearranging it:

$$PR * (C_e + C_l) = I$$

$$PR * \frac{(C_e + C_l)}{C_l} = \frac{I}{C_l}$$

$$PR * \left(\frac{C_e}{C_l} + 1\right) = \frac{I}{C_l}$$

By definition, income divided by the lending capital is the rate of interest, i.e., **IR**. The ratio of equity capital to the lending capital will be denoted by **CR** (capital ratio). Then we obtain:

$$IR = PR * (CR + 1)$$

This is the relation between the rate of profit and the rate of interest we were looking for. Note what follows from it. Since the bank's equity capital always exists, then **CR** will always be a quantity greater than 0, but still a relatively small number less than 1. Due to the latter, the value of **(CR+1)** will always be bigger than 1. Let us now realize what the above means. It states that the rate of interest and rate of profit are not one and the same thing. As long as **CR** is not zero, both rates can never be equal. The interest rate will always be greater than the rate of profit. Note that what we discussed applies not only to a single bank but to all banks in general. That is why we can say that the base (natural) rate of interest in the economy must be higher than the rate of profit. Still, as mentioned previously, the rate of interest described above is the „average“ one, i.e., the resulting rate of interest after we average over all loans given and over some time period (e.g., over a year).

Why is the rate of interest higher than the rate of profit? The answer is: due to the existence of capital necessary to make the lending process possible. We postulated implicitly that all capital in the economy should get equal returns, which applies to the equity capital. It must be compensated in the same way as any other form of capital. However, its very existence

necessitates a higher rate of overall return. This capital consists of people, machines, buildings, etc., i.e., all resources necessary in order to manage the lending process.

We should ask ourselves if the capital to manage lending has to do with the risk incurred in the lending process itself. In our view, even if there were no risks involved, i.e., even if we found ourselves in some imaginary risk-free economy, we would still need capital to manage the lending process. In other words, the existence of management capital is unavoidable. This capital will be much higher in a real economy, where risk is unavoidably present. This will be due to the need to provide a monetary cushion for the case of outright business losses. Therefore, the management capital will always have to include some additional monetary funds to cover the risk involved in lending. Thus in our view, the real (measurable) rate of interest will always be higher than the rate of profit, but it will be the risk component in an economy that adds significantly to this difference.

Let us now see where this leads. In a real economy, the rate of interest will always surpass the rate of profit. If capital is being lent, it will be lent to companies/entities that will generate a significantly higher rate of profit than the average. Thus, the free economic capital will be distributed to the most promising investment projects, i.e., to projects that will contribute the most to economic growth. An economic project with an average or under average profit rate would simply not generate enough return to justify taking a loan. On its side, the capital for lending will be available since banks will pay their savers the going rate of profit (which is lower than the rate of interest). This monetary capital will come from private savings and savings of companies that can not profitably invest their free (surplus) funds at this particular moment.

What about the capital ratio discussed (**CR**)? In our view, this ratio (of management capital to lending capital) is a technologically determined parameter. For example, banks nowadays tend to switch a big part of their activities to online banking. The latter includes their loan-management departments. In this way, less capital will be needed for the same amount of loans to be given. Thus we should expect that in the future, due to the general economic progress, less and less management capital will be needed for the same amount of loaned capital. Thus **CR** will constantly decrease and tend towards zero, but still, it will never reach it. In this way, we expect the „pure“ interest rate (i.e., excluding the risk component; when we average over all bank clients and over time) to tend toward the rate of profit. Still, due to the amount of risk inherent to every existing economy, the rate of interest will always be greater than the rate of profit.

Let us now come back to the above-derived formula. What it shows is a relation between the rate of interest and the rate of profit. What it does not say, however, is which one determines the other. There are two possible ways to find out the above.

The first is to see the timing relation between the variables, i.e., to see which one comes before the other and if such a dependency is observed, then the former is the cause and the latter the effect. From this point of view, the rate of profit is the cause/the determinant of the rate of interest, since, for money to be lent (and therefore for interest to exist at all), this money must have been saved out of the profit previously.

The second way is to determine if the rate of profit can exist without the rate of interest. We can describe such a closed free-market economy. In it, the existing companies will invest all that has been saved in themselves. They will never lend money to other companies. Since no amount of accumulated savings will be lent, no interest will be generated, and consequently, no interest rate can be defined. Although a very inordinate one, such an economy can exist, and it will grow because the necessary investment will be available for that purpose. Since the money for investment will not be lent out, it will not be used for the most profitable prospective projects available but for some lesser ones. The latter will lead to slower growth, but growth nevertheless. Thus the second option also points out that the rate of profit determines the rate of interest.

In conclusion, we can generalize the relation: The rate of interest is determined by the rate of profit and the capital ratio, i.e., the right side of the formula determines the left side.

The idea of the primacy of the rate of profit can be traced to Reisman (1996), where he introduces his „Net consumption, net investment theory of profit and interest“ (Reisman 1996, ch.16). However, we should note that the justification we used to prove that the rate of profit determines the rate of interest has nothing to do with the one used by Reisman. As to the above-mentioned theory, we are of the opinion that it is incorrect. To summarize the problem: Reisman claims that the reason why aggregate profit as such exists is due to the existence of consumption on the part of the businessmen. And this consumption, according to Reisman, comes from funds such as „paid dividends,“ etc. The problem is that the very existence of dividends presupposes the existence of profit since dividends are paid out of profits. Thus Reisman uses circular reasoning in order to justify the existence of aggregate profit by (implicitly) presuming that it exists. The latter is what makes the mentioned theory invalid in our opinion.

## **Rate of profit in a free-market economy**

What we have established so far is that the rate of profit determines the rate of interest. This conclusion changes our question from „What determines the rate of interest?“ to „What determines the rate of profit?“ in a free-market economy.

The rate of profit as a macro-economic value can, for instance, be represented as the sum of all individual profits (and losses) in an economy divided by the whole economic capital, measured at the current market prices. Other definitions, which relate the micro-economic to the macro-economic parameters, are possible, as long as they are used consistently for analysis purposes. Irrespective of this, the profit rate is a parameter that must describe what a company is expected to gain if it successfully takes part in the particular market.

In our opinion, the macroeconomic existence of (aggregate) profit and from there of the rate of profit can be explained simply by the fact that businessmen wish to be compensated for their efforts. We accept as given that labor has a price, i.e., that ordinary workers in companies expect to be paid/compensated for their efforts. Company owners are not different in this respect. The only significant difference is that they are the ones responsible for organizing how much they will earn. Through their control over the economy businessmen reserve a part of the economic resources for their own use as compensation for their productive effort. Thus the reason why profits exist is the same as the one why labor has a price.

Let us now try to determine the rate of profit in a closed free-market economy with a fixed monetary supply. As discussed earlier, we expect that if such an economy grows, it will grow without net saving (on a macro-economic level). In such a stationary growth state, all economic profits and salaries are entirely consumed since nothing is saved on average. Therefore the sum of all profits and salaries is precisely equal to the quantity of consumer goods being produced. Since the overall amount of capital (measured at current market prices) is fixed, then the rate of profit is determined by the ratio of the consumer goods production to the overall amount of capital (measured at current market prices) and the percentage of profits in the overall consumption.

The latter can clearly be seen in the case when net saving appears. In economic structure terms, the net saving process will transfer economic resources to the investment fund as described in detail in Ninov (2021) and thus increase the fixed capital goods production at the expense of consumer goods production. As a result, our accumulated savings fund will grow. Thus if, for instance, the accumulated savings fund is 100 monetary units and the rate of return on it is 10%,

then 110 monetary units will be returned from investing it. In the stationary growth state, the mentioned 10 surplus monetary units would be consumed. But if the economic agents decide to save all or a part of this surplus, then net saving will appear, and the accumulated savings fund will grow from 100 to 110 maximum.

Once the net saving process ends, the economy will restructure and come to a new stationary growth state with a higher growth rate and lower consumer goods production. Since, as described previously, all profits and salaries in the new state will again be entirely consumed, but the consumer goods production is now lower, then profits and salaries will decrease all around. Since the overall amount of economic capital (already redistributed) will stay the same, the rate of profit will go down, and the rate of interest will follow.

The case when net dis-saving appears is not much different. It describes the opposite capital redistribution process, in which capital is being moved towards more consumer goods production. The latter leads to an increase in the profits and salaries in the economy since more goods for consumption are available. As a consequence, the rate of profit and the rate of interest will increase proportionally.

We found out that the rate of profit (and consequently the rate of interest) is directly determined by the structure of the economy and, in particular, by the distribution of resources between capital goods and consumer goods production processes. Unfortunately, we can not be more precise since salaries are also included in the overall consumption, but the ratio of profits to salaries in an economy is not apparent. Thus, we described a very general economic relation, which can only be used for descriptive purposes.

Let us now summarize our general view. By choosing to save or dis-save and consequently increase or decrease the investment fund, the economic agents determine the structure of the economy. The structure itself, particularly the distribution of capital between consumer goods and fixed capital goods production, determines the rate of profit for the particular economy. Finally, the rate of profit directly determines the rate of interest.

An interesting question is if the rate of profit (and consequently the rate of interest) can become zero or negative. Within the limits of our model, i.e., in a closed free-market economy with a fixed monetary supply and under normal circumstances (i.e., excluding economic crises caused by natural disasters, wars, etc.), we see no such a possibility. The model does not allow for the latter to happen. In such a growing, retrogressing, stagnating, or restructuring (due to net-saving/dis-saving) economy, the rate of profit (and consequently the rate of interest) can never

become zero or negative. In crisis situations (e.g., a natural disaster), however, the rate of profit can drop below zero due to the economy-wide losses sustained by most companies. The latter will bring the natural rate of interest down (i.e., most banks will lose capital), but the nominal/measurable interest rate will still stay positive due to the immediate jump of the risk component.

## Conclusions

We established that every economy possesses a fund of accumulated savings, which is self-sustaining and can be used repetitively for investment purposes, thus avoiding the necessity of net saving for economic growth to take place. The interest rate, as such, was defined by the interest earned on this part of the accumulated savings that has been lent, as opposed to the one used directly for investment by the companies and that earns a profit. We showed how, under the simplifying assumption of a closed, free-market economy with a fixed monetary supply, the rate of interest is determined directly by the rate of profit. As a consequence, the rate of interest becomes a dependent variable. Moreover, we proved that the rate of profit and the rate of interest are not the same thing and showed how profit could exist without interest being present. Later, we discussed how the structure of the economy, particularly the distribution of capital between consumer goods and capital goods production, determines the rate of profit directly and, consequently, the rate of interest.

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