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## Anarchism and Austrian Economics

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### I. Introduction

It is a great honor for me to give the Cuhel Memorial Lecture at the Prague Conference on Political Economy for 2011. Franz Cuhel rightly holds an honored place in the development of the pure theory of the Austrian school of economics.<sup>1</sup> Ludwig von Mises credits Cuhel (1907) with providing the first presentation of a strict ordinal marginal utility analysis. The confusion in choice theory that eventually led to the purging of the human element in the economic analysis of decision making would have been avoided had Cuhel's ordinal presentation of marginal utility analysis been more widely accepted. Instead, it was for Mises (1949) and later Rothbard (1962b) to develop that presentation and offer it as an alternative to the neoclassical theory of microeconomics that developed after John Hicks' (1939) *Value and Capital*.

The implications, I would argue, are far greater than the technical issues of ordinal versus cardinal utility and the subsequent debate among ordinal utility theorists of marginal utility analysis and demonstrated preference versus marginal rates of substitution and indifference curve analysis, etc. The implications of the debate in choice theory go to the core of how we view the individual that we study in economics.<sup>2</sup> The

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<sup>1</sup> See Hudik (2007) for an overview of Cuhel's life and work.

<sup>2</sup> Focus should be on the substantive economics of the human chooser in Mises's first part of *Human Action* (1949) rather than his philosophical defense of methodological dualism and the apriori nature of economic theory. More recently, Richard Wagner (2010, 1-26) discusses the differences between 'closed maximization' versus 'open action' for economic analysis and social sciences more generally more cogently to my mind than any other contemporary example.

optimizing agent who must maximize against given constraints belongs to the world of Hicks, but the human actor who is fallible yet capable, who must balance between alluring hopes and haunting fears, belongs to the world of Cuhel and Mises. “Choice” theory in the Hicksian presentation is close-ended, I would argue, while choice in the Misesian framework is open-ended. The implications of this go not only to the way we conceive of the individual in economic analysis, but ultimately determines our analysis of the impact that the diversity of institutions within which men act will have on their acts of choice, their exchange relationships, and their ability to realize the gains from trade, and the gains from innovation.

Adam Smith long ago taught us that man has a natural propensity to truck, barter and exchange, and Thomas Hobbes also warned us of man’s propensity to rape, pillage and plunder. Which human propensity dominates any social environment is a function of the institutions in place that provide the rewards and penalties in social intercourse. But this institutional analysis requires that our model of the act of individual choice in economics is logical (predictably rational), yet indeterminate in manifestation. In other words, what is “rational” is contextual in nature, and not acontextual, or to use the language of Vernon Smith (2007), rationality in economics should be conceived of as ecological and not constructivist.

The open-endedness of human action can be captured in the ordinal analysis laid out by Cuhel (1907) and developed by Mises (1949), whereas the closed and robotic agent fits with the analysis of decision-making provided by Hicks and the subsequent developments of neo-classical price theory. And, as the German sociologist Hans Albert (1979; 2010) acutely argued long ago, the institutional deficiency that was evident in

1950-1970 neoclassical economics would never be completely repaired until the behavioral foundations of neoclassical economics are changed.<sup>3</sup> The maximizing actor model cannot accommodate institutional analysis without diluting it to the point of non-existence.<sup>4</sup> Instead, we need to engage in rational choice analysis as if the choosers were human actors, and this enables us to do institutional analysis as if history and culture mattered. In short, only by moving away from the economics of automatons and the twin obsessions of optimizing and equilibrium, and instead focus on the economics of human actors with a focus on perception of opportunity and processes of adjustment to change can we see how the institutional context of choice not only structures incentives, but shapes the choice context faced by the individual.

While Cuhel's work was a contribution to positive economic theory, I want to argue that this approach to the logic of human action provides the foundation for subsequent developments in comparative political economy that addressed questions in institutional analysis. Thus, my title – “Austrian Economics and Anarchism.”

This title is meant to be startling at first sight. Adherents of the Austrian school of economics claim their work to be a scientific body of thought, and not a normative

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<sup>3</sup> It is important to stress that a goal of neoclassical economists in this period was to develop an ‘institutionally antiseptic’ theory, and this led to the counter-reaction of what latter was termed “New Institutionalism” in economics --- e.g., property rights, law and economics, public choice, ‘new’ economic history, etc. See the discussion of this counter-reactions in economics and also his discussion of ‘new’ versus ‘neo’ institutionalism in Eggertsson's *Economic Behavior and Institutions* (1990).

<sup>4</sup> An important illustration of this point is the development of the theory of market socialism by Oskar Lange (1936) and Abba Lerner (1944); though also see Lavoie (1985). They both argued that in the realm of pure theory what they had demonstrated was that the model of market socialism could mimic the efficiency results of the model of capitalism, but that in practice the model of market socialism would outperform the model of capitalism because they could eliminate the real-world problems of capitalism associated with monopoly, externalities, and business cycles. The point I want to emphasize is the pure theory point --- in the model the institutional differences between socialism and capitalism were completely neutralized. Lange went as far in his essay to accuse Mises of “institutionalism” because he thought economic calculation depending on private property. And, in Milton Friedman's (1947) review essay on *Lerner's The Economics of Control* he stressed that it was a mistake for economists to engage in public policy analysis as if administration were done inside of an institutional vacuum.

political doctrine. Correctly so, I agree. And clearly anarchism is an extreme and even romantic political doctrine as far removed from science in the public imagination as is possible. How can the two be put in the same title?<sup>5</sup>

But it is also true that for the audience to which I am addressing, perhaps my title is not startling at all, but in fact commonplace. The sophisticated audience here at the Prague Conference in Political Economy is no doubt familiar with the radical libertarian writings of Murray Rothbard (1970, 1973, 1982) and those who follow Rothbard such as Walter Block (1976) or Hans Herman Hoppe (2001). Rothbard, Block and Hoppe are foremost representatives of the individualistic and anarcho-capitalist camp of *normative political economy*, and they also are self-styled Austrian economists. Whatever my criticisms, or sympathies, are with the Rothbardian approach, that is decidedly *not* what I intend to discuss here. My intent to startle remains. Rather than discuss the normative political theory doctrine of anarcho-capitalism, my focus is on the *positive political economy of anarchism* and its relationship to the *positive* economic theory of the Austrian school of economics. In the end I hope to persuade my intended audience that the study of anarchism is part of a progressive research program in contemporary Austrian economics.<sup>6</sup>

The right way to view this paper is as an invitation to inquiry into situations where “alternative institutions that support economic activity when a government is

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<sup>5</sup> One easy way to square this is to emphasize the Schumpeterian point about the necessity of pre-analytic cognitive acts (what he called ‘vision’ and what others might call ‘ideology’) for the analytic cognitive acts that are the domain of positive science (what he called ‘analysis’). So an anarchist vision would lead one to engage in analysis differently than an alternative vision, but the positive science concerning the analysis can be judged independently from one’s assessment of the vision. I appreciate this point, but that is not the way I am going to pursue my argument.

<sup>6</sup> See my essay “Anarchism as a Progressive Research Program in Political Economy” (Boettke 2005). Also see the comprehensive survey of the literature by Powell and Stringham (2009).

unable or unwilling to provide adequate protection of property rights and enforcement of contracts through the machinery of state laws.” (Dixit 2004, vii) It is an effort to persuade students of Austrian economics, that embracing an empirically oriented research program focusing on the institutional analysis of situations of self-governance is not only an exciting intellectual endeavor, but perhaps the best way to advance the theoretical and methodological tradition of the Austrian school of economics in the context of modern scientific economics.

By the positive political economy of anarchism I mean simply the study of historical and contemporary situations where the rules (and their enforcement) that govern social intercourse are not provided, for whatever reason, by a geographic monopoly supplier of law and order. And I am particular interested in those social relations that concern the recognition of property rights, the keeping of promises, and the transference of goods and service through consent. In standard economic analysis the institutions within which economic activity takes places are treated as given. The rules of the game and their enforcement are *exogenously* provided and constitute the social framework within which individuals engage in economic activity. The positive political economy of anarchism does not accept this assumption of exogenously provided institutions. Instead, the research program we are describing focuses on *endogenous* rule formation.<sup>7</sup>

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<sup>7</sup> James Buchanan (2011) has recently argued again that endogenous rule formation cannot be trusted precisely because there is no analogous profit-loss mechanism in operation in the selection of the framework of rules. This position of Buchanan’s is not new, and Israel Kirzner (2000) also shares Buchanan’s skepticism. Though more controversial of an interpretation, but I would argue that Rothbard also would argue that a spontaneous order analysis of the framework was intellectually flawed and that a more exogenous analysis of the framework would be required. (see, e.g., Rothbard 1962a) For Buchanan, the framework results from a pre-constitutional process of rational discourse that results in agreement on the rules, whereas to Kirzner and Rothbard the framework is provided by moral discourse over individual rights and commonly accepted social mores.

## II. The Soviet and Post-Soviet Context of Trading Outside of the Law

As a matter of empirical reality, there are plenty of exchange relationships that take place in an environment where the rules of the game are in fact still up for question, and certainly not enforced by any legitimated geographic monopoly of coercion. The current market for illegal drugs in the US is one such environment, just as the market for alcohol during the era of Prohibition, but one could also describe the anonymous dealings on the internet involving perfectly legal commodities as transacted on sites from E-Bay to Craigslist in this manner as well.<sup>8</sup>

My interest in endogenous rule formation environments actually began with my studies of the Soviet economy. My Austrian school perspective had alerted me to the fact that Soviet central planning could not have been the operating principle for the economy due to the Mises-Hayek critique of socialism.<sup>9</sup> The disjoint between how the system was supposed to work, and how it really worked became a major theme of my work (e.g., Boettke 1993, chapters 3-4) --- and I wasn't alone as this assessment was shared by many economists, political scientists, and historians who studied the Soviet system up close and personal. But those who approached the system from afar, tended to obscure the operating principles of Soviet political economy both inside the official planning system and outside that system in the different "colored markets" that ranged from extra-planning system that enabled state enterprises to meet planned production targets to the underground market in consumer goods that provided some answer to consumer frustrations.

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<sup>8</sup> One recent estimate put the magnitude of organized criminal activity at 15% of world output.

<sup>9</sup> See my essay on "Coase, Communism, and the 'Black Box' of the Soviet-Type Firm," in Steven Medema, ed. (1998).

In the late 1950s and early 1960s, as Sovietologists gained access to the system that they had been denied since the ascendancy of Stalin observed that the Soviet planning system didn't work according to known models of optimal planning, but instead through a hodgepodge of exchange relations and make work alternative supply chains in production.<sup>10</sup> The social glue that held the system together was not the rational plans of Soviet managers, but the system of privileges and side-payments that emerged to coordinate the economic behavior of bureaucrats, managers, and ordinary citizens. 'Blat' is higher than Stalin, was a common phrase used to explain how the informal economic system held together. These informal arrangements were neither defined nor enforced by any central authority of law and order, but through a variety of private mechanisms of social cooperation.

Identifying these private mechanisms and the *de facto* property rights and the stream of rents they produced was vital for the analysis of the post-communist transition. And, obviously the standard assumptions of *given* clearly defined and strictly enforced property rights by the state does not apply. The state capacity to define and enforce property rights and freedom of contract was what was being developed. But economic life couldn't wait until that state capacity was in place. There is, in short, an *endogenous rules* formation process that we have to recognize and study. There is *ordered anarchy* both in terms of market theory and the price system and the framework within which the market process guided through relative prices is played out.

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<sup>10</sup> The consequences of the Soviet system being effectively closed off after this period of "thaw" were dire for economic analysis, and steered economic research from the mid-1960s away from this "on the ground" approach to either escape theoretically into mathematical modeling of planning, or empirically into efforts to reassess the economic growth figures Soviet statistical agencies reported. Only during the 1980s did economists start to get back to the economic analysis of the organizational logic of the Soviet system. See Boettke (1990, 1993, 2001).



The political economy of this ordered anarchy is not just evident in Soviet and post-Soviet example. In fact, the ordered anarchy of everyday life exists throughout history and across cultures. The way I have put the issue so far given the exclusive Soviet context, is in fact overly pessimistic.<sup>11</sup> If you read carefully, it will appear as if I am arguing that the informal arrangements are what exists in the Soviet and post-Soviet environment, but everyone would be better off if we could get the state capacity to define and enforce property rights. We only rely on the informal because we cannot yet rely on the formal.<sup>12</sup> But the day we get formal mechanisms in place, the better off everyone will be. *This reading of my argument would be wrong.* Informal institutions not only serve as the basis of social order, and ultimately constrain the legitimacy of the formal institutions that the state attempts to impose on the population in question, but they can in many circumstances simply outperform any conceivable set of formal institutions that will emerge in the future given the realities of the situation and the range of possible types of government that would be introduced.

Chinese entrepreneurs, for example, have found the informal institutions to be more secure and thus have made long term investments. The situation is different in Russia even though they apparently have formal laws that should provide such security,

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<sup>11</sup> In my analysis of Soviet and post-Soviet life I have emphasized the mechanisms that result due to the “black market” nature of the economy and have emphasized the dark side of the “connection based” economy as opposed to the “contract based” economy. As I have often stressed, if the market economy can be characterized as the “strength of weak ties”, the Soviet type economy can be characterized as the “weakness of strong ties” – to flip a result from economic sociology. Thus, the mechanism that I focused on in dealing with the Soviet black market dealings were repeat dealings among actors who relied on family ties and with recourse to extra-legal enforcement. And the work tended to focus on how the post-communist extra-legal enforcement agents emerged from the communist era extra-legal enforcement agents who had ties to the party.

<sup>12</sup> Though I would argue that a challenge for researchers in the positive political economy of anarchism must confront is the difference between “emergence” and “development”. There are plenty of examples of how institutions have emerged historically to enable complex contractual relationships to be realized (see, e.g., the work by Stringham (2003) on the rise of stock exchanges) but the historical reality is that the formal apparatus of state law and order did follow and lead to the greater development of these institutions. So is there an objective limit to “anarchy” or can do we see “anarchy unbound”?

but there remains a lack of trust (see Rodrik, et. al., 2004). Claudia Williamson (2009) has found that the informal institutions that are in operation in any society are a greater determinant of economic performance than the formal institutions of governance. “Good” informal will work to minimize the negative influence of “bad” formal institutions, and will work to reinforce the positive influence of “good” formal institutions. She concludes that yes, institutions rule, but it is informal institutions that really rule. And Leeson and Williamson (2009) argue that in the situations of transition economies (post-communism), less developed economies (e.g., Africa and Latin America), and failed and weak states (e.g., Middle East and Africa) realism is needed, not romance. Governments equipped with power to protect private property have to be constrained in order to prevent government members from abusing their power to predate on citizens. In countries where governments are not effectively constrained, government activity tends to favor members of the ruling elite, making increases in government involvement undesirable from the perspective of economic development. The informal sector in such instances is not only more attractive to individuals in that situation but from the perspective of a realistic political economy would be more productive.

That observation demonstrates the contemporary relevance of recognizing the possibility that escaping from government might be more desirable than living under government. (see, e.g., Scott 2009) But we have to move the analysis from “what happened” and “why it happens” ultimately to “how it happens.” How does this system of informal institutions work so that individuals can coordinate their plans, realize the gains from trade, and realize the gains from innovation? And can it?

My example of the *samizdat* economy during the Soviet Union enabled individuals to alleviate consumer frustrations in the black-market for commodities, and it allowed managers of Soviet firms to meet the targets of planning authorities by relying on the extra-plan process of bartering and swapping of resources among state firms through intermediaries. But what it didn't do was allow the Soviet economy to realize the gains from social cooperation under the division of labor. As a result, while life muddled through in a way that it could not have had they not had recourse to the informal sector, the sort of economic growth that characterizes a vibrant society eluded the population. Just as the *samizdat* intellectual culture gave some relief from oppressive tyranny while not overcoming it, the *samizdat* economic life did not permit individuals to escape the economic deprivation of the Soviet system.

The real question in the post-communist situation was whether or not the *samizdat* political and economic life of the communist era could serve as the basis for the rise of a working democracy and vibrant market economy.<sup>13</sup> It turned out that the idea that all that was needed was the development of the formal institutional capacity of the state to define and enforce property rights proved to be naïve for the very reasons identified by Leeson and Williamson (2009). But the movement from a low income country to a middle income country and from a middle income country to a high income country does require the *endogenous* evolution of rules of property and contract that takes time.<sup>14</sup> We learn this not only from close study of the transitioning and developing economies, but also from a study of the development of Western civilization. There is a process of two-tiered entrepreneurship that is in operation during the development process. Development does

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<sup>13</sup> See Boettke (1993, chapter 7).

<sup>14</sup> On the process of economic development see Bauer's *From Subsistence to Exchange* (2004).

follow from individuals realizing the gains from trade, and realizing the gains from innovation through entrepreneurial action, but there is also the entrepreneurial act of rule-creation and enforcement that individuals within social settings must engage in *if* those gains from social cooperation under the division of labor are to be realized. (see Leeson and Boettke 2009)

### III. Rules, Strangers and Living Better Together

What must those rules do if they are to accomplish the goal of realizing the gains from social cooperation under the division of labor, and since access to a central enforcer is denied in these situations how do these rules operate as self-enforcing? That is the fundamental question all researchers on *endogenous rules* must address. Rules that are not respected aren't effective rules; they remain only notional rules. On the other hand, rules that require extremely costly methods of enforcement will not on net be beneficial as they will give by necessity increasing scope for predatory behavior.<sup>15</sup> In order to realize the gains from social cooperation, rules must simultaneously limit predation and maximize the opportunities for mutually beneficial exchange.

Such rules govern the use of resources and our social interactions with one another. Hume recognized that the fundamental institutions of social order were property, contract and consent. We must delineate “mine and thine”, we must keep promises, and we must respect transference of property by consensual trade. So at the most basic level, the rules that govern property, contract and consent must become established. At the next level, we must recognize that in an endogenous rule formation

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<sup>15</sup> As Spinoza wrote, “He who tries to determine everything by law, will foment crime rather than lessen it.” The work of Chris Coyne on the post-war efforts of reconstruction addresses this issue in detail, see Coyne (2007).

process that we can distinguish between form and function in rules. The vast diversity of human institutions we find across cultures and through time does not mean that the gains from social cooperation under the division of labor can be realized under any conceivable set of rules. The rules might take on the form that is culturally specific, but the function they serve is more universally recognizable: they must *limit access* to scarce resources, they must make individual decision makers *accountable* for their use of that resource, and they must introduce *graduated penalties* for those that violate the first two. In Elinor Ostrom's various studies of common-pool resources, this is what she has discovered.<sup>16</sup> And we see the universal character of these functions when we study covenants with and without swords in the field as well as in the lab (see Ostrom, Walker and Gardner 1992). Ostrom's work challenges the Hobbesian presumption that covenants without the sword are but mere words and thus cannot serve as the basis of a secure social order. She finds in a variety of circumstances instead what I have called a Smithian solution to a Hobbesian problem (see Boettke 2009, also see Boettke 2010). We can observe that human beings have a tremendous capacity for self-governance even in situations where we might least expect it to be viable.

But observation is not analysis; it demands analysis. In short, institutional analysis must move to a third stage of analysis I would argue which focuses on *mechanisms* of inclusion and exclusion. Standard theory suggests that self-governance is capable in the limited environment of small groups of homogenous agents who possess low discount rates. But such environment cannot realize the great gains of social cooperation under the division of labor. The cooperation in anonymity that is exhibited

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<sup>16</sup> For an overview of the research program of Elinor and Vincent Ostrom and what is called the Bloomington School of Institutional Analysis see Aligica and Boettke (2009).

in the vast division of labor is among such a large group that the number of exchanges, Adam Smith argued, far exceeds our computation. In fact, the puzzle as Smith put it in *The Wealth of Nations* (1776, 18) is that while we stand in need of the cooperation of a great multitude of individuals in order to survive, we have the ability to make but a few close friends in our lifetime. Thus, we cannot rely on benevolence alone for our survival. We must, and do, rely on the elicitation of cooperation through appealing to self-interest. It is not from the benevolence of the butcher, the baker or the brewer that we get our dinner, but from their self-interest. But again it is not self-interest alone, it is instead the marshaling of self-interest via the institutions of property, contract and consent that coordinates the production plans of some with the consumption demands of others. And this cooperation and coordination takes places among anonymous strangers and who are often geographically and socially distant from the market transaction and the people who are striking the deal.

Adam Smith gave us the puzzle that as economists we must solve. We often forgot it was a puzzle because we take it for granted since we come to it not as an unknown but amazingly familiar with the situation. Too familiar, I would argue.<sup>17</sup> Smith invites us to be amazed at what we immediately observe everyday. We need to permit ourselves to see the mystery in the mundane. Smith (1776, 15-16) asked us to contemplate the complexity of the exchange relationships required to produce a simple woolen coat, and Milton Friedman (borrowing from Leonard Read) held up a pencil and asked his audience to contemplate the same thing as the cover to his *Free to Choose*

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<sup>17</sup> This, I would argue, is one of the reasons economists were complacent in dealing with the “pretense of knowledge” and the “fatal conceit” that Hayek identified throughout his career. As Hayek said “The curious task of economics is to demonstrate to men how little they know about what they imagine they can design.” (1988)

(1980). I ask you today to engage in that same thought experiment on your shoes, your backpack, or your computer. How many exchange relationships are required for you to enjoy the products that you take for granted? And how is it that the people involved in this set of complex relationships come to trust one another even though they have never met, never spoken, and most likely will never meet. The institutions of property, prices and profit/loss work to facilitate trust where personal relationships are non-existent.

This “ordered anarchy” of the market is recognized by almost all practicing economists, at least at some level. Still the 18<sup>th</sup> and 19<sup>th</sup> century doctrine of laissez faire has sometimes been described by critics as “anarchy with a constable” and the focus of much of 20<sup>th</sup> century economics was intended to demonstrate the shortcomings of the “ordered anarchy” of the market. Instead of self-regulation, state regulation was required for economic arrangements to be efficiently organized. Complicated contractual relationships required law and order, and could not develop based on profit and loss alone. I cannot adequately address this argument here, but in the narrative of economic theory and applied political economy that I am constructing the mainstream of 20<sup>th</sup> century economics is overly pessimistic about “ordered anarchy” and overly optimistic about “reasonable regulation”.

#### IV. A Plea for Mechanism in the Study of Anarchy

As mentioned above mankind has exhibited throughout history two overwhelming propensities: (a) a propensity to truck, barter and exchange; and (b) a propensity to rape, pillage and plunder. Which propensity is manifested in history is a function of the institutions that men find themselves interacting with one another within. And at their

core these institutions are about property, contract and consent. The social games based on realizing the mutual gains from trade, are radically different from the social games based on predation. When property is not respected, when there is no expectation of promises being kept, and consent is not required, then predatory relationships will dominate the social game. On the other hand, if property is respected, promises are kept, and consent is required, then mutual beneficial exchange relationships will dominate the social game. Predatory societies are poor and sick, exchange based societies are healthy and wealthy.

But the critical question is the *mechanism* of self-enforcement that permits this exchange-based order to develop. And as mentioned above, to realize the great gains from social cooperation under the division of labor these mechanisms must work among anonymous actors characterized by great geographic and social distance. But the working capacity for standard mechanisms of self-governance, such as reputation, are pushed to the limit as geographic and social distance rises. Think of the puzzle this way, we have the most to gain in exchange from those that are most distant from us, yet precisely because of that distance we have the least reason to trust them. Strangers are both potentially our greatest teachers, and our worst fear.

To ensure our relationships with strangers are mutually beneficial, the mechanisms of self-governance must be transformed to take into account the changing social situation. Or to put it another way, either we must find mechanisms that transform the situation with strangers into a situation of in-group social intercourse, or we must have in operation mechanisms that build trust in institutions that permit cooperation among strangers. In short, we have to identify historically the mechanisms that *excluded*



actors who could threaten the social order, and the mechanism that *include* those actors who could improve the social order through mutual beneficial exchange.

Among modern Austrian economists, the two economists who have done more on the examination of the mechanisms that make ordered anarchy possible are Edward Stringham and Peter Leeson. Both take seriously the standard game-theoretic result that social cooperation without a geographic monopolist in law and order can only occur in small group settings with homogeneous agents who have low discount rates. Their work, however, respectively demonstrates that this standard theoretical result is defied repeatedly throughout history and in fact in everyday life in the contemporary world. Social cooperation within large group settings of heterogeneous agents happens all the time.<sup>18</sup> When history appears to defy what logic dictates, the economists must show why it appears that way, and how the logic is actually played out in that situation. The “how it works,” question is answered by explicating the mechanism in operation.

Stringham’s (1999, 2002, 2003) work has tended to focus on how through the use of “club-like” arrangements, mechanisms of excluding potential bad traders takes place. Stringham emphasizes that most of the literature focuses on the potential effectiveness of *ex post* punishment. But historically, those engaged in the complicated exchange relationship would rather avoid any of the costs associated with *ex post* punishment, they would prefer to have *ex ante* sorting mechanisms that weed out potential bad-faith traders. We do not come into trading relationships with a tattoo on our heads that says “trustworthy” or “cheater”, but various institutions have evolved throughout time and across historical circumstances that attempt to approximate that. And the “club-like”

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<sup>18</sup> And often even with actors that have high discount rates, see Leeson’s work on pirate communities (2009a) and another example is Skarbek’s (2010) work on prison gangs.

arrangements Stringham has studied reveal amazing creativity in efforts at *ex ante* sorting while minimizing the cost of excluding. Stringham mechanisms tend to transform large-group settings into more manageable small group settings, and to pre-sort the group so that even though the population pool is heterogeneous those who are accepted into the club are more or less homogeneous on the character trait that matters for the group. Self-enforcement is thus obtained through these *ex ante* methods of sorting.

Leeson's (2007, 2008, 2009a, 2009b) work, on the other hand, has tended to focus on Mises's argument concerning social cooperation under the division of labor, and show how strangers find mechanisms to become *included* in the trading community.<sup>19</sup> But Leeson hasn't limited his creative energies to situations of how strangers signal their trustworthiness to potential trading partners, but his work has spanned over a variety of historical circumstances where it would be least likely for the theoretical mechanisms he has explicated to work. In other words, while he started out trying to explain how actors overcome geographic and social distance to realize the gains from social cooperation under the division of labor, his subsequent studies have touched upon not only the *ex ante signaling mechanisms* (e.g., Leeson 2008) but the role that *ex post enforcement mechanisms* play in producing social order (e.g., 2007 and 2009b).

So we have in the recent work of Stringham and Leeson an exploration far beyond the original discussions of the Soviet and post-Soviet situation. They have demonstrated

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<sup>19</sup> In his chapter on "Human Society", Mises (1949) explains how sympathy, friendship and a sense of belonging follow from realizing the great gains from social cooperation under the division of labor. And he stresses the arrow of causation. It is because specialization and trade increases productivity and wealth that humanity can enjoy the fruits of sympathy, friendship and community. If specialization and exchange did not yield great productivity and wealth creation, then mankind would have forever been destined to be trapped in a relentless struggle for survival and would view each other as deadly foes competing by whatever means to secure a portion of the scarce resources necessary for sustenance provided by nature. He would be in constant conflict with any other creature he encountered. It is this caricature of the human condition (more than the absence of a sovereign as Hobbes postulated) that would produce a life for man that was "nasty, brutish and short."

that complicated exchange relationships have emerged and developed in the absence of any geographic monopoly of formal law and order. Sometimes the rules of the game in the historical examples they examine are implicit and enforced by the social sanction of ostracism exclusively, but in many instances they have identified explicit rules and elaborate enforcements as a penalty for violating the rules. In all the cases, the *endogenous rules* they have identified serve to allow individuals in those situations to realize the gains from social cooperation under the division of labor.

There remains much work to be done.

## V. Conclusion

The Austrian school of economics from its founding has emphasized the logic of human action, and the spontaneous order of the market. Contributors to that tradition such as Menger and Hayek, have also explained how the framework institutions of morals, money and law are examples of institutions that arise not from the brow of a genius, but as the by-product of individuals striving to better their condition in the world and in so doing seeking out the gains from social cooperation. Morals, money, and law, as well as the market economy itself, are prime examples of institutions that are “the result of human action, but not of human design.” But note something of importance --- morals, money, and law are framework institutions, the market economy operates within that framework. In short, from Menger as well as Hayek we learn that the most important questions in the sciences of man concern the mechanisms by which the spontaneous evolution of the framework is established, as well as the spontaneous order of the market that exists inside of that framework.

The *positive political economy of anarchism* follows as a research program naturally from this emphasis on spontaneous order one finds in the Austrian school. We cannot treat institutions as given, and we cannot treat state governmental capacity as either easily established or benign in operation. As a result, the research program of positive political economy of anarchism is empirical and possesses contemporary relevance.

That contemporary relevance is not limited to the post-communist, developing countries or after-war reconstruction situations. Instead, the contemporary relevance can be seen in the contemporary efforts to escape the state provision of public goods in schooling and health, in the rise of private communities, and in the persistence of various private dispute resolution mechanisms and even the growing market share of private security forces. And, perhaps most relevant for the young scholars in attendance – the relevance of research on anarchism is not tied to the *normative* anarchist theory that has had some connection to the Austrian school (whatever your judgment is on that work) but can address what the *Economist* recently referred to as “the great political issue of our times.”<sup>20</sup> And that ‘issue of our times’ is the fiscal crisis that has spread through the western world and the need to reign in the growth of the state and tame Leviathan. Such exercises require a rethinking of the scale and scope of government. In the process of such rethinking, we can explore the old classical liberal wisdom that we must limit the scope of government to those things, and only those things, that it does well, and leave to the market and to civil society those things the government cannot do well. The answer to that question is up for the next generation to answer. The answer provided by your

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<sup>20</sup> See the March 19<sup>th</sup> 2011 edition of *The Economist* and the special issue on “Taming Leviathan”.

ancestors was wrong, and the answer provided by my generation has proven wrong, it is time for your generation to get it right. As the *Economist* reports, the Chinese policy maker Ma Hong recently argued that “We are in a transition from a big state to a small state, and from a small society to a big society.” As we turn more and more to civil society and the market economy to substitute for the state, the mechanisms in operation that permit individuals to realize the gains from social cooperation under the division of labor will need to be continually explicated in our research and communicated in your writing and lecturing. Austrian economics is a progressive research program in economic science, and the *positive political economy of anarchism* is perhaps its best testing ground to prove its worth against the competitive research paradigms in modern economics and the social sciences.

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