Professor W. Milberg
New School for Social Research
Seminar in Economic Methodology
Spring 2008

Theory Appraisal Essay
Cameron M. Weber
February14, 2008

Essay on “Property Rights and Time Preference” by Robert F. Mulligan in the *Quarterly Journal of Austrian Economics* (Spring 2007)

I. Introduction and Methodological Approach to this Essay

After a synopsis of the subject article, this paper analyzes the author’s approach to methodology in answer to three questions,

1) How does the author assert his claims to economic knowledge?
2) Does the author apply his stated or implicit approach in advancing his argument?
3) Is the author’s approach successful?

II. Synopsis of “Property Rights and Time Preference”

The author makes the claim that time preference is subjective to the individual economic agent, but that these preferences are influenced by objective external factors, especially “property rights security” (p. 43). The author proposes that a decrease in property rights security increases the time preference and should increase interest rates as a decrease in time preference encourages borrowing over saving, and conversely an improvement in property rights regimes should decrease interest rates.

The author then applies a historical perspective and states,

> In contrast with the formerly ascendant Marxian view which associated collective ownership with a higher state of civilization, the enhancement of property rights proceeds with the evolution of civilization and government. As individuals come to recognize and value property rights, they become free to implement more productive, roundabout, capital-using production methods….However, once capital-using society evolves to a state where the government becomes dominated by self-seeking bureaucrats and politicians, the liberal order seem inevitably to break apart into competing interest groups seeking to monopolize the government’s unlimited rent-extraction authority. The liberal order evolves through the inexorable political economy of the democratic process into outright socialism, or at least into welfare statism” (p. 43).

The author argues that socialism and the welfare state ("mixed economy") fail to recognize that property rights are a necessary condition for a liberal order, which means that in a "sufficiently advanced and complex society" (p. 43) the interest rate moves in a cyclical pattern traced by the changing time preferences influenced by the advancement and retreat of property right regimes in the democracy.

III. The Appraisal of Theory

Our first question is, "How does the author assert his claims to economic knowledge?" It is safe to say that our author is clearly working within a Lakatosian *hard core* surrounded by a *protective belt*, as the article is published in a journal devoted to the Austrian School of Economics, a school of thought which is very much in the "covering law" tradition. In this tradition the author draws on the works of Menger, Bohn-Bawerk, Mises, Kirzner and Hoppe, along with others outside of this *hard core* such as Hicks, Jevons, de Soto, Arrow, Tullock, Fisher, Modgliani and Schumpeter to make his case for methodological individualism, the influence of culture on time preference, the time preference theory of interest rates, and rent-seeking in democracies and thus the growth of government in democracies.

The author cites three empirical studies to further his argument. The first shows that taxes were "relatively low" (p. 34) from medieval times until after the Industrial Revolution (Cipollo 1980). The second shows a "U curve for interest rates over the course of society's evolution and decay" (p. 34) (Homer and Sylla 1996). The author then uses this U curve analysis to illustrate a cyclical pattern of interest rates; one cycle from WWI to the 1940s, another peak in the 1970s, and suggests that today we are in "the bottom of the bowl" (p. 35). The third empirical study is that of de Soto (1989) who shows that, "Lack of secure wealth and transferable property rights prevents third world nations from accumulating wealth and productive capital" (p. 23).

Lastly the author makes the claim that, "in modern times inflation supersedes all other methods in importance. The higher the rate of inflation, the less secure property rights become" (p. 37), and uses Fisher (1896) to show that as inflation increases demand for loanable funds shifts to shorter maturities and supply shifts to longer maturities. The interest rate is set by arbitrage between these two subjective preferences.

In summary, the majority of the author's argument rests on *a priori* reasoning (or Rationalist philosophy) based on Austrian School methodology of deductive logic, while some *a posteriori* empiricism is used to buttress this reasoning. I would like to say that this is an example of the hypothetico-deductive model, using the symmetry thesis of prediction and explanation. However the author's argument fails Popper's falsification test as the author does not set-up a falsifiable hypothesis. I would also like to propose that the author's approach is "positive" economics and not "normative" economics because the author does not make any policy recommendations and frames the argument from an "is" perspective, not an "aught" perspective.

The second question we set out to answer is, "Does the author apply his stated or implicit approach in advancing his argument?" The author does not explicitly state a methodological approach in his paper, but we know that because it is in the QJAE the author will use primarily deductive reasoning. He does state that, "both theoretical and operational-empirical definitions are presented" (p. 25), so using this statement as a standard by which to judge whether or not he met his stated approach, the answer is "yes."

Our last question is, "Is the author's approach successful?" In my opinion the author presents a tightly-reasoned argument for subjective time preferences as the basis for interest rate levels and the importance of property rights in influencing these subjective time preferences. However what is missing from the paper is empirical macroeconomic evidence showing the growth of government in modern democracies since World War Two and more robust evidence of the cyclical movement of interest rates based on changing political eras, e.g. the decrease in government during the Clinton administration and the current growth of government under the George W. Bush administration. However given the readership of the QJAE the author may rightly assume this is common knowledge. In summary, I propose that "yes", except for some missing empirical data on growth of government, the author is successful in his methodological approach.