

Prof. Bryan Caplan  
bcaplan@gmu.edu  
<http://www.bcaplan.com>  
Econ 854

## Week 14: Anarchy

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- I. Economic Arguments for Government
  - A. Econ textbooks have a standard list of economic arguments for government intervention:
    1. Monopoly
    2. Imperfect information
    3. Public goods/externalities
    4. High transaction costs
    5. The most recent addition: irrationality.
  - B. From a comparative institutions perspective, these are unconvincing. After all, all of these “market failures” can and do afflict governments, too.
  - C. Some would argue that these problems are actually *worse* for government. Consider:
    1. Monopoly: How about the two-party system?
    2. Imperfect information: How about voter ignorance?
    3. Public goods/externalities: How about sensible voting as a public good?
    4. High transactions costs: Look how hard it is to “buy out” teachers’ unions, turnpike workers, and kleptocrats.
    5. Irrationality: Isn’t voter irrationality vastly worse than consumer or producer irrationality?
  - D. It is particularly hard to wean economists away from the public goods rationale for government. (In fact, it is a struggle to get economists to stop equating “government spending” with “spending on public goods”!)
  - E. The source of its appeal: The intuition that, “Public goods problems don't solve themselves.”
- II. The Paradox of Public Good Provision
  - A. Isn't monitoring the government to act in socially beneficial ways itself a public good?
  - B. The Paradox: If citizens can voluntarily produce the public good of monitoring government, why can't they solve other public goods problems without government? If they can't voluntarily solve this problem, what reason is there to expect government to improve matters?
  - C. Cowen and Kavka (2003) offer several solutions to this paradox:
    1. The tying hypothesis. This is very similar to the stationary bandit model: As long as leaders have a reasonably long time horizon, socially beneficial policies are a *private* good for government leaders.

2. Altruism and noise hypothesis. Governments can leverage a small initial altruistic donation. “The establishment of a government... may require a smaller number of acts of altruistic support than non-monopolistic mechanisms for producing public goods would require. Unlike a competitive firm, once a monopolistic government obtains a certain amount of initial support, it can use its monopoly power to induce continued support in the future.”
  3. Bootstrap hypothesis: Support for government is really a coordination game, not a Prisoners’ Dilemma, because if most people support a state that provides public goods, it is selfishly optimal for you to do so as well.
- D. From discussion with Tyler: Unless anarchy is better than government, government must *on net* produce public goods.
- III. Are the Functions of the Night-Watchman State Really Public Goods?
- A. OK, so what about anarchy?
  - B. If you remain dissatisfied with democracy, reject constitutional reform (even futarchy!) as a solution, and abhor dictatorship, anarchy is all that’s left.
  - C. There is a surprisingly large economic literature on the possibility of “free-market anarchism” or “anarcho-capitalism,” beginning in 1849 with Gustave de Molinari’s article, “The Production of Security” in the *Journal des Economistes*. See Stringham’s *Anarchy and the Law* for a broad survey.
  - D. Ferdinand Lasalle was not imagining things when he attacked, “Those modern barbarians who hate the state – not this or that state, not this or that state-form, but the state altogether. And who, as they now and again have clearly admitted, would most prefer to abolish the state, auction off justice and police to the cheapest suppliers, and have war run by joint-stock companies, so that there should nowhere in all of creation still be an ethical point from which resistance could be offered to their capital-armed mania for exploitation.”
  - E. Our analytical procedure: Start with the functions of the night-watchman state (NWS) – dispute resolution, rule formation, and enforcement – and work backwards.
  - F. Specifically: What aspects, if any, of these functions are really public goods?
- IV. Dispute Resolution as a Private Good
- A. Two people have a contract dispute. The night-watchman state takes it upon itself to adjudicate. For disputes it labels “criminal,” the NWS goes further by handling the prosecution.
  - B. Why? Where is the public good? Why couldn’t the parties (or their insurers) simply put an arbitration clause in their contracts, which the night-watchman state enforces? And why does the NWS have to handle the prosecution itself?

- C. Hard case for arbitration: complete strangers. Night-watchman state could still minimize its role by compelling defendant to choose from an approved set of arbitrators.
- D. Hard case for private prosecution: indigent defendants.
- V. Rule Formation as a Private Good
  - A. The NWS also takes it upon itself to pass civil and criminal laws.
  - B. Why? Where is the public good? Private arbitration firms could (and to some extent already do) ex ante woo customers by offering the most efficient set of rules.
    - 1. Efficient rules give parties incentives to maximize joint wealth of signatories, factoring in expected cost of disputes.
  - C. Landes and Posner argue that lack of intellectual property rights in precedents leaves little incentive for rule formation.
  - D. In practice, though, public courts often defer to expert judgments of arbitrators. Intellectual property rights in rules could be strengthened, and non-patent incentives are often effective.
- VI. Enforcement as a Private Good
  - A. The NWS also tries to monopolize enforcement.
  - B. Why? Where is the public good? Once an arbitrator makes a decision, why can't it be enforced by ostracism, bonding, or private security guards?
  - C. An unconventional solution to the problem of indigence and crime: indentured servitude and private prisons.
  - D. NWS could again mechanically defer to arbitrators' decisions.
- VII. Moderate versus Radical Privatization
  - A. To a surprising extent, markets already share the supposedly exclusive turf of the NWS.
    - 1. Private security
    - 2. Arbitration
    - 3. Arbitrators' codes of rules
    - 4. Bonding
    - 5. Credit ratings
    - 6. Ostracism
  - B. It would be easy to drastically expand the role of the market in these areas, while leaving the state as the final authority. Let us call this *moderate* privatization.
  - C. But this is hardly an alternative to government, because the state remains – and decides how far the alternatives are allowed to go.
  - D. What about *radical* privatization - getting rid of the last remnants of the NWS state?
  - E. What would this even look like? Standard picture:
    - 1. Individuals subscribe to services of a defense firm.
    - 2. Defense firms arbitrate their disputes in private courts.
    - 3. Private courts issue monetary judgments.
    - 4. Reliable people unable to pay their debts have their earnings attached.

5. Others, especially criminals, become indentured servants and work off their debt in private prisons that bid for inmates.
- VIII. Main Objections to Radical Privatization
- A. Obviously, free-market anarchism is not a popular proposal. What are the main objections?
  - B. "Externalities of defense services."
    1. Reply: These have more to do with current policy than the nature of the product. If police only help paying customers, if judges charge for adjudication, if victims who prosecute win restitution, where is the externality?
    2. Turnaround: Government defense has lots of externalities. Bureaucrats who make the world safer get paid the same as those who don't. Oftentimes "crusaders" become very popular by causing the crime they claim to be fighting (e.g. Prohibition).
  - C. "It would lead to violent chaos."
    1. Reply: Why? It is cheaper to negotiate than to fight, especially since police companies repeatedly interact with each other. Also, police company employees, unlike conscripts, have to be paid more for a riskier job.
    2. Turnaround: Existence of government leads to wars, which are far more serious than police agency shoot-outs because governments control the resources of the whole society.
  - D. One strong agency would take over and become the new government." (Alternate version: Agencies would merge until they had a monopoly).
    1. Reply: This would only be possible if there were a large MES relative to the demand for defense services. In the current U.S., there are already about 10,000 security guard companies, so there is little reason to fear the dominance of one strong agency.
    2. Turnaround: A much bigger risk from governments, since their MES is much larger than for mere police agencies.
  - E. "Police agencies would build up demand by defending their clients to the death."
    1. Reply: This would create a severe "adverse selection" problem, just like the one that insurance companies face. If you announce that you will protect your clients to the death, you encourage high-risk, lawless people to hire you, raising your costs enormously.
  - F. "People would have no incentive to prosecute crimes."
    1. Reply: Monetary restitution provides the incentive; the ability to impose indentured servitude ensures that almost all convicted persons will be solvent.

2. Turnaround: This is true today: the only incentive of victims to cooperate with prosecutors is desire for revenge. E.g. rape victims are often better off staying quiet.
- G. "Criminals would be over-punished."
1. Reply: In many ways, profit-making prisons would be more humane: there is an incentive to protect the safety of workers, to separate workers by size and strength, and to provide useful job training. Legal codes could incorporate prisoner protection as well.
  2. Turnaround: Numerous non-violent offenders are currently sentenced to harsh prison conditions.
- H. Others?
- IX. Cowen, Anarchism, and Collusion
- A. Tyler Cowen has a novel objection to free-market anarchism: Defense is a *network industry*. Collusion is relatively easy to orchestrate in such industries due to the threat of expulsion.
1. There might seem to be a lot of firms, but for practical purposes there will only be one.
- B. In such industries, some forms of collusion (relating to product standardization) are actually beneficial; but this opens the door to the traditional forms of inefficient collusion (like price-fixing).
- C. According to Cowen, this leaves basically two possible cases:
1. Case 1: Transactions costs are low enough to make collusion work. Then both the efficient and inefficient forms of collusion thrive. The public faces a profit-driven monopoly defense firm, a great example of Hobbes' Leviathan.
  2. Case 2: Transactions costs are too high to make collusion work. Then neither the efficient or the inefficient forms of collusion appear. The public faces chaos, a great example of Hobbes' "state of nature."
- D. Stringham and I reply to Cowen in the *RAE*. Main argument: Cowen conflates coordination problems with prisoners' dilemmas.
- E. Product standardization is a coordination problem. Once firms expect certain standards to prevail, it pays to conform.
- F. Price-fixing, extortion, etc. are prisoners' dilemmas. If other firms are changing high prices and mistreating customers, it pays to stay honest and gain their business.
- G. Historically, network industries do not seem to have been especially able to achieve collusive outcomes, but they have solved a lot of coordination problems:
1. After anti-trust: Credit cards
  2. Before anti-trust: Clearinghouses
- X. National Defense
- A. What about national defense? Isn't that clearly a public good?

- B. Answer: It depends. “National defense” is not a public good for the *world* because if no country had “national defense,” no country would need it!
  - C. Implication: Countries’ “national defense” programs are often a public bad – and the losers typically include their own citizens.
  - D. Simplest reply to the national defense objection: Our country’s national defense is a public bad, and both we and the rest of the world would be safer without it.
    - 1. This argument became far more convincing after the fall of the Soviet Union.
  - E. Still, how would a free-market anarchist society defend itself against invasion by an aggressive state? Surely *that* would be a public good.
  - F. Answers:
    - 1. Voluntary charity. Members of the anarchist society could volunteer both money and their labor to defend their society from attack.
    - 2. Ideology. A successful anarchist society would have many external sympathizers, making it difficult to rationalize aggression. Look at how little the capitalist world did to crush the Soviet Union in its infancy.
  - G. If this seems naïve, consider a Tullockian challenge: “Give me one good reason not to invade Brazil.”
- XI. The Transition Problem
- A. The biggest challenge to anarcho-capitalism: The transition problem. How do we get from here to there?
  - B. Most radical movements consider violent revolution. But even if this were feasible, what are the odds that violent revolution would create a *freer* society, much less a free society?
    - 1. David Friedman’s quip: “Revolution *is* the hell of it.”
  - C. From a libertarian point of view, most revolutions are a complete disaster. Even the American Revolution is greatly overrated by libertarians – government didn’t really shrink, and the rights of slaves and Indians would have been better protected by the British.
    - 1. Question: Are revolutions a good example of the idea trap?
  - D. Other options are viable for marginal change, but offer little hope of radical change in the foreseeable future:
    - 1. Persuasion
    - 2. Infiltrating the political system to take advantage of slack
    - 3. Coordinated movement to change the median voter (e.g. the Free State Project)
  - E. What about just creating a new society?
    - 1. “Create your own country” projects end in failure or conquest by neighboring old country.
    - 2. Paul Romer’s solution: Charter cities
    - 3. Patri Friedman’s solution: Seasteading

- F. My case against fatalism: Radical change is very difficult to achieve, but what sensible person ever thought otherwise? To quote Tollison, "We're all part of the equilibrium." You can still make a marginal difference – and do good while doing well.