

REJOINDER TO DAVID FRIEDMAN ON THE ECONOMICS OF ANARCHY

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The received wisdom once stated that anarcho-capitalism would collapse into Hobbes's state of nature, with life nasty, short, and brutish. The problem of competing governments is the problem of externality par excellence. But David Friedman, among others, has argued persuasively that privately financed arbitration agencies can overcome the basic externalities problems behind social order.

Unfortunately the matter is not so simple, because the state - a coercive monopoly on the use of force - may reemerge. Like most advocates of libertarian anarchy, Friedman wishes to have it both ways. Private protection agencies are supposed to be able to produce public goods by cooperating. But somehow collusion, which is a public good for the firms in question (if not for all of society), is supposed to be impossible or unstable.

My initial piece argued that the same mechanisms that encourage interagency cooperation also would allow agency collusion. Friedman's comment has not changed my mind about the soundness of this conclusion.¹

The industry for protection services is particularly vulnerable to collusion because it is what I call a network industry. Specifically, the industry is characterized by the following features:

1. Firms that do not have friendly, cooperative relations with the other firms in the -same industry cannot capture market share. Private protection agencies under anarchy differ from Friedman's example of the grocery industry. I do not mind patronizing a Safeway that is having a price war with another rival supermarket, but I do mind patronizing a protection agency whose decisions are ignored by other agencies. This means that if there is a dominant protection cartel, customers will patronize the cartel, not the lower-price upstarts.
2. Protection firms with differing law codes must offer a form of quality collusion that provides a common product (a final decision) to their respective customers when interests clash. These firms must have contractual agreements to cooperate when a potential conflict of interest is present.
3. A cooperating network of protection service agencies could use aggressive force to enforce its market domination (Friedman does concede this point, although he doubts its likelihood).
4. The adjudication network is stable only if it can use force to put down outlaw agencies that do not accept its higher-order arbitration decisions. Such a network also could use force to put down firms that do not adhere to the collusive agreement.

The adjudication network could divide the market into exclusive territories and institute taxation. Each firm belonging to the network would agree not to deal with upstart firms, or with firms that violated the common agreement to monopolize. Under this agreement the forces that usually break down cartels - new entrants and renegade colluders - cannot obtain market share.

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1. See Cowen (1992). I refer interested readers also to Caplan (1993), another (unpublished) critical comment on my original piece. Caplan argues that anarcho-capitalist protection firms need only bilateral relations, not a network, and that bilateral relations would not imply collusion.

WHAT HAPPENS TO NONCOOPERATING FIRMS UNDER ANARCHY?

Friedman assumes that the adjudication network need not implement violence or the threat of violence against noncooperators. They can simply let these firms, which supposedly must settle their conflicts with violence, go out of business.

Friedman and I agree that outlaw firms will not prosper but we have different reasons for holding this belief; these reasons lead to different conclusions about the likelihood of collusion. Friedman thinks that outlaw firms will lose customers because of competitive market forces. But competitive forces could conceivably favor such firms. How would competitive market forces alone prevent an outlaw firm from increasing its business by promising never to turn over its guilty customers for imprisonment or trial?²

I think this kind of outlaw firm will fail, but not because customers will automatically stop patronizing it. The threat of violence from the network can enforce compliance, or the network could brand such firms as renegades and cut off all relations with them. Nonconforming firms will lose market share and go out of business because they cannot promise peaceful adjudication. But we should not be so quick to jump on the anarchist bandwagon. The disciplinary actions of the network that put down these outlaws are precisely the actions that could enforce collusion as well.

Friedman also thinks that an anarcho-capitalist society would be safer from a power grab than a government. He cites ideology as the relevant constraint in both cases - "The restraints which prevent a military coup are essentially restraints interior to the men with guns." Friedman portrays government officials as more power-hungry than businessmen and thus more dangerous. I did not deal with this issue in my original piece, but I am nonetheless skeptical about Friedman's argument.

Businessmen and government officials differ little with respect to temperament. Electing businessmen to political office, even average ones (as opposed to those who deliberately seek election), would not change the tyranny of government much. In addition, businessmen, if in a position to engineer a coup through the network, might prove more efficient and cost-effective than their public-sector counterparts. A privately owned network holds out the possibility of residual claimancy and profits, which makes the likelihood of a coup through the network greater.

Finally, Friedman thinks that there will be a very large number of protection agencies, thus making collusion more difficult. But today there are a very large number of police forces and local governments, yet they still collude. In the network the number of truly independent sources of power is likely to be small. It is not the number of police forces that matters' it is the number of sources for final-order arbitration.

Perhaps Friedman has in mind a world where the number of independent protection agencies is initially so large that a collusive network cannot get off the ground. But if collusion, one public good among agencies, cannot be provided, neither can the punishment of renegades be provided, another public good among agencies. We cannot have it both ways.

Furthermore, a large number of small agencies implies only that the resulting pools of collusion will be geographically limited. Rather than a united Europe, we will have the Swiss confederacy. A smaller government may or may not be a better government, but it is a government nonetheless. And over time, we can expect some amount of consolidation among these groups of small governments, just as we have seen throughout world history.

Governments often do terrible things, but the reason we observe them so frequently is because they are the predominant form that a stable equilibrium takes. If getting rid of a geographic monopoly of coercive power is Our goal, my conclusion, unfortunately, is one of guarded pessimism.

²Friedman seems to assume that an outlaw firm can only take the form of a firm that settles all disputes by brute force.

REFERENCES

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