

Overlapping Jurisdictions, Proprietary Communities, and Competition in the Realm of Law

by

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FREY [2001] and others propose subjecting governments to competition within their jurisdiction, but classical liberals argue that having competing law enforcers cannot work. This article describes a hybrid system that relies on markets but has one law enforcement agency per region, with profit motivated proprietors policing their properties. Vertically integrated proprietary communities wishing to attract customers would need to police their property in a way that patrons desire. Although a monopoly on the use of force would exist, bundling law with real estate makes the law enforcer the residual claimant and creates incentives for them to not to expropriate their clientele. (JEL: D 740, H 100, K 400, L 330)

1 Introduction

Quis custodiet ipsos custodios (who watches the watchman)? The problem of how to make law enforcers act in the interest of their subjects has perplexed theorists since ancient times. Most political economists argue in favor of constitutional constraints, but as TULLOCK [1987, p. 317] points out, any government that is strong enough to enforce the law is strong enough to break the law.¹ The law is often bureaucratic or, even worse, used to control or extract resources from the public (BENSON [1994]). This has led some economists to propose subjecting government authorities to competition, even within its own jurisdiction. In a recent article in this journal, FREY [2001] proposes a system of what he calls “Functional, Overlapping, and Competing Jurisdictions” where people would be free to purchase the service of any “government” regardless of their jurisdiction. This idea is in line with the radical libertarian proposal to eliminate government monopoly in all areas includ-

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¹ TULLOCK [1987, p. 317] writes, “The view that the government can be bound by specific provisions is naïve. Something must enforce those provisions, and whatever it is that enforces them is itself unbound.”

ing law (BENSON [1988]; BLOCK AND DILORENZO [2000, p. 580]; DOWD [1997]). Competition has the potential to make the relationship between providers and consumers of law consensual (KERBER [2000a, p. 223]) and to encourage discoveries of better ways of producing order (VANBERG AND KERBER [1994, pp. 201–206]; STRINGHAM [1999, pp. 64–67]).

Although the benefits of competition are recognized by most economists, most are still unwilling to completely eliminate government's monopoly over the use of force. In response to Frey, EICHBERGER [2001, p. 178] writes, "A legal system, jurisdiction, regulation, and enforcement of rules require territorial government," and KERBER [2001, p. 181] writes, "a consistent legal order needs the monopoly of power ... we should therefore not reject all kinds of governments with territorial monopolies." Likewise, classical liberal theorists such as COWEN [1992], SUTTER [1995], and before them NOZICK [1974], have responded to the proposal to eliminate the government monopoly over law, arguing that just because government agents may not have the best incentives, does not prove that competition would do any better. They argue that a system with competition is unstable because competing agencies would come into conflict and any solution to their problems would lead to the demise of the system. If competing agencies can steer clear of warfare and agree to cooperate, this same mechanism will enable them to form government or at least act as a cartel (COWEN AND SUTTER [1999]).

All of these authors make a significant advance over earlier contributors to political economy who disregarded the potential for competition in the law without consideration. Instead of dismissing the idea out of hand, Cowen, Eichberger, Kerber, Nozick, and Sutter offer well reasoned arguments why multiple police forces might have difficulties operating in the same jurisdiction. This article argues, however, that even if one agrees with the analysis of these classical liberals, whose arguments are grouped together here, one need not conclude that police need be provided by the state. These classical liberals criticize one conception of a non-government monopoly system, but this article maintains that this conception is not the only one. In an alternative conception of a non-government monopoly system, which is composed of vertically integrated proprietary communities that provide law, each region may include only one law enforcer but one that is private and motivated by profits. In some sense one could think of it as replacing public governments with profit motivated shareholder "governments."² In a system with law enforcement privately provided by proprietary communities, the arguments about conflicts between agencies in one region are inapplicable.

The important question then becomes whether the profit motivated monopolist law enforcement would act against the wishes of the clients given that transaction costs of moving will exist. This article discusses how vertical integration of law enforcement and real estate structures the incentives of a law enforcement system

² Following the classifications of BLOCK AND DILORENZO [2001, p. 40], a proprietary community would not be classified as government because it is contractual, profit motivated, and not government in the traditional sense.

differently than traditional political constraints. If law enforcement is provided by for-profit owners of land, any opportunistic behavior against customers would lead to less rent from that land. Vertical integration avoids the traditional pitfalls associated with both government and itinerant police who may take advantage of exit costs and exert power on unwilling subjects. In contrast to other systems, giving the responsibility of law to the residual claimant of an area gives proprietors the incentive to offer the package of real estate and law that consumers value most.

2 *Two Alternatives to Traditional Government Monopoly of Law*

2.1 *Law Enforcement Provided by Agencies with Overlapping Jurisdictions*

What are the alternatives to a government monopoly over the use of force? One can imagine a continuum with varying amounts of private and government enforcement of law or systems where government regulates competition (HASNAS [2003]), but let us consider two prototypical positions where government involvement is completely absent. Two elements within the proposals to eliminate government's monopoly over law require differentiation. The first position is that within a geographical area there should be multiple law enforcement agencies. The second is that law enforcement services should be contractual however it may appear. Most people assume that these go hand in hand, but this is not necessarily the case. Let us look at the two elements in turn.

For the theorists who focus on the first element, opposition to government monopoly takes the form of favoring multiple firms in a decentralized system.³ Theorists in this tradition outline a system in which law would be enforced by multiple competing agencies within the same geographic area (BARNETT [1986]; FRIEDMAN [1989]). They provide in depth speculation about how neighbors who subscribe to different law enforcement agencies could settle disputes. People could send their police agency to their neighbor's house (even if the neighbor subscribed to a different police agency) and it would be up to the two police agencies to resolve the situation (FRIEDMAN [1989, p. 115]).

One potential problem, however, is having police enforcing laws on non-customers and many of the theorists in this tradition argue that this is okay (TANNEHILL AND TANNEHILL [1970, p. 94]). Friedman writes:

“[R]emember that in our society the law under which you are judged depends on the country, state, and even city in which you happen to be. Under the arrangements I am describing, it depends on your protective agency and the agency of the person you accuse of a crime or who accuses you of a crime.” (FRIEDMAN [1989, p. 117])

Law would be determined by the customer and if the customer is willing to pay to enforce strict laws, others around him must comply or must hire an agency

³ TANNEHILL AND TANNEHILL [1970, p. 79], for example, oppose a monopoly of law enforcement even if agreed to.

willing to protect them from such laws. Because everyone would be subject to a potentially limitless number of enforcement agencies, many relationships may be non-contractual and may even be quite illiberal (EICHBERGER [2001, p. 178]; COWEN [1992, p. 256]; FRIEDMAN [1989, pp. 127–131]). Giving multiple law enforcement agencies the ability to enforce laws on individuals who may well be innocent makes libertarian theorists such as NOZICK [1974, p. 88] uneasy. COWEN [1992, pp. 255f.] also argues that even if people subscribed to different agencies a *de facto* monopoly would emerge, because the agencies would need to agree to a common set of guidelines to settle interagency disputes. To COWEN AND SUTTER [2005], this common agreement would enable agencies to act as cartel and act against the wishes of the public.

2.2 *Law Enforcement Provided by Proprietary Communities*

To eliminate the problem of individuals hiring police who impose legal procedures that might wrongly harm their neighbors, theorists usually believe market mechanisms for law enforcement must be avoided (or at least regulated by a higher government if private law enforcement is to exist at all). Conventional wisdom suggests that the choice is either government provided/controlled law enforcement *or* complete freedom of entry in the exercise of coercive power in any given area. But this article submits a third major position, one comprised of market chosen law enforcement *and* restrictions on who can exercise coercive power.

Under such a system there would be market relationships in the area of law enforcement but there may very well be territorial sovereigns where coercive power is monopolized. The field of law includes the concept *lex loci delicti*, which means “the law of place of the tort prevails.” Since under radical libertarianism all property would be private, the proposal here is that each owner decides the laws of his land, and guests would agree upon entering the property. According to this perspective, the issue is not the number of law enforcement agencies but whether the relationships are contractual.

Law enforcement differs from the typical good where there is simply a consumer and a producer who both gain in a transaction. Law enforcement, in contrast, involves the party who requests it, the party who produces it, and the parties who are subject to it, and depending on the institutional setting, all these groups need not agree or benefit. Although the person who requests the service and the producer benefit from a transaction, the same cannot be said of a third party if it has no contractual relationship with the others. To those who esteem the principles of voluntarism and a society based on contract, the fact that law enforcement is private is necessary but not sufficient. This position is not just concerned with whether law enforcement is done on a for-profit basis, but whether relationships are contractual (CARNIS [1999, p. 92]). The goal would be to have all parties involved with a law enforcement agency agree, not only the consumers and producers of the law but the subjects as well (STRINGHAM [1999]).

Although at first glance this might not seem possible, it can be done in many ways. Consider how it is done in business where before transacting parties sign an arbitration agreement to follow certain procedures or arbitrators in case of dispute. Even though there is the arbitrator, plus *two* other parties, before business takes place all agree. The fact that everyone was willing to sign the agreement demonstrates that it is *ex ante* utility enhancing to all parties involved (SHAVELL [1995]). However an arbitrator or private judge may decide in any given case, he does so in a way that all parties have agreed to ahead of time. This contrasts with a system in which two parties do not agree *ex ante* and thus considerable conflict over the rules or the best way to proceed may arise. Allowing people to select a legal system *ex post* gives at least the potential for plaintiffs to engage in forum shopping. Even though an accused may consider a law enforcement system risky or outright illegitimate, if someone charges him in that court he must defend himself.⁴ If, on the other hand, people must select an arbitration procedure *before* interacting, the problems of being roped into what they consider a kangaroo court should not arise.

In the case of business relationships how this works is fairly clear, because by having arbitration clauses businesses already follow similar procedures (BENSON [2000]), but when individuals walk down the street and encounter various strangers, is such agreement still possible? Why would a purse-snatcher ever want to agree to the same anti-theft rules as his victims? In this area too the principles would be the same. Under a system of private property, anyone who entered someone's land would be entering into agreement with the owner and his other guests that any disputes will be handled by the procedures in place for that property. This is not unlike how many proprietary communities already act today (MACCALLUM [1997]).⁵ Contemporary universities, for example, have fairly comprehensive systems of rule enforcement and deal with most disputes between students internally (STRINGHAM [1999, pp. 55ff.]). When students attend these schools, one service they are agreeing to and paying for is the university's system of security. In the case of a clash, the school's procedures, which the students have selected by going to the school, will deal with the matter. Because universities compete for students they must offer the package of rules that best serves their customers. Here is an example of "tort law," which just like arbitration agreements, is contractual and *ex ante* utility enhancing to all parties involved.

Private *lex loci delicti* would not require every individual to act as his own police force to protect his small plot of land. In any given apartment building, each tenant would not hire his own security guards. Since the apartment building is owned by a landlord, the landlord decides what security will be provided. In this case the proper unit of analysis is not each apartment but the building as a whole. Similarly,

⁴ As NOZICK [1974, p. 98] put it, "An acute problem is presented if two groups each believe their own procedures to be reliable while believing that of the other group to be very dangerous."

⁵ Current governments do impose certain restrictions on proprietary communities' ability to enforce laws, just as they impose certain restrictions on companies' ability to use arbitration clauses (TREBILCOCK [1993]).

private neighborhoods and private road owners could have their own security that would handle street crimes for that property (ROTHBARD [1996, p. 218]).

In these cases the only security officers one would deal with would be those authorized by proprietors. For example, when one chooses to enter Disneyland, the only security guards one sees are those of Disney. Likewise, the only other people one deals with are patrons who also agree to follow the park rules. Under such a system, when a property owner wants to invite guests, he needs to provide a system of rules attractive enough that all his visitors would willingly agree. A complete market based system would enable property owners to create any type of rule they wanted, and their guests could decide to come or not (OSTERFELD [1983, p. 341]). Unless the owners and the guests decided otherwise, territorial sovereigns would handle disputes, and the disputes would be between people who were contractually bound, like those who have signed an arbitration clause. Under these arrangements, parties would not be subject to legal procedures they deemed unfair because the procedures would be chosen by all participants.

It is important to note that this system does not require that everyone in the world agrees to live under the same rules. In fact, different people might choose quite disparate rules for their own property (HASNAS [1995]). It only requires that customers agree to follow their specific proprietor's rules. Those rules might differ in different communities and it could even be possible for a community to have no rules, but in all cases parties would be in a position to decide before interacting. VANBERG AND KERBER [1994, p. 201] argue that competition between jurisdictions would be a knowledge creating process. Even if customer preferences and the optimal set of rules are unknown today, competing jurisdictions could try different ways of doing things to attract business.⁶ Vertically integrated proprietary communities would need to innovate in the area of law just as they need to innovate on other margins. For example, Las Vegas casinos continually improve their package of services and if one of the components of the package is a well policed property they will continually need to offer superior policing as well. As will be discussed below, having law enforcement provided by proprietary communities will not be able to solve every imaginable problem but it may solve quite a few.

2.3 Difference between the Two Alternatives to Traditional Government Monopoly of Law

Those advocating overlapping jurisdictions judge a system based on the ability of customers to deal with multiple enforcement agencies, while those advocating proprietary communities judge a system based on its contractual nature. If one accepts a libertarian framework of property rights as in NOZICK [1974], it seems reasonable to judge the legitimacy of a governing institution on whether it is based on private property and contract rather than how it appears. This position requires no

⁶ One of the main differences between the competition described here and the competition described in KERBER AND VANBERG [1995] is the jurisdictions described in KERBER AND VANBERG [1995, p. 46] do not have a single owner or residual claimant.

specific number of firms or concentration ratios; what matters is that law enforcers have been preselected by all parties involved. If a market based system can exist without multiple agencies in each geographic area, the picture changes dramatically.

An absence of many competing firms does not mean the market is malfunctioning in this view. As long as consumers voluntarily choose the product, one knows that a firm's dominant position is due to customer satisfaction (ROTHBARD [1993, pp. 560–660]). Because most libertarian economists reject standard structure-conduct-performance analysis (GUNDERSON [1989, p. 135]), they need not define market based law enforcement in a comparable manner. ROTHBARD [1977, p. 2] says that defense in a free society would be from firms who “(a) gained their revenue voluntarily and (b) did not—as the State does—arrogate to themselves a compulsory monopoly of police or judicial protection.” The key in this statement is that the government *arrogates* a monopoly of law, not that it is a monopoly. If a “monopoly” is chosen it is another matter.⁷

Some might wonder whether any modern day governments meet the conditions of being chosen and voluntary. Although constitutional political economists such as BUCHANAN AND TULLOCK [1999, p. 10] often argue that government rules *ex ante* agreed upon by all parties involved, this agreement is only “conceptual” (BUCHANAN AND TULLOCK [1999, p. 26]) and as BLOCK AND DILORENZO [2000, p. 580] write, in reality “no state ever has been, or ever could be, voluntary” even at the constitutional phase. SPOONER [1973, pp. 11–29] writes that because neither he nor anyone he ever met had signed the U.S. Constitution it should not be considered a binding contract. The U.S. Constitution can at most bind the small minority of Americans who signed it or who agree to it today, but it cannot be considered a voluntary contract with the many Americans who opposed it in 1787 (BLOCK AND DILORENZO [2000, pp. 577f.]) or those who oppose it today. One of the main differences between traditional governments and private proprietary communities is proprietary communities involve actual unanimity of those governed whereas traditional governments do not. BLOCK AND DILORENZO [2001, p. 40] argue that even if an institution provided “public goods” “if it were truly voluntary, there would be no need to label it as ‘government.’” For example, even though Disneyland provides many municipal services including security, it would not be classified as a government because the development is private and voluntary (FOLDVARY [1994, pp. 114–133]). FOLDVARY [1994, pp. 52–62] and BLOCK AND DILORENZO [2000], [2001] describe the differences between imposed *versus* consensual governance in more detail.

⁷ Here institutions would be judged on how they formed, not how they appear. This is illustrated by SIMON [1991, p. 27] describing a Martian viewing earth through a scope that displays market transactions as red and firms as green. To his surprise, a market economy would appear as “large green areas interconnected by red lines” rather than “a network of red lines connecting green spots.” This story could also apply to private law enforcement. On all property law might be enforced by a monopoly, but if that entity were the property owner who was not subject to taxation, this would meet the conditions of a non-governmental system.

Table 1
Three Major Approaches to Law Enforcement

	Government monopoly of law enforcement	Law enforcement with overlapping jurisdictions	Law enforcement with proprietary communities
For profit law enforcement allowed	no	yes	yes
Is the relationship between consumer and law enforcer contractual?	no ⁸	yes	yes
Is the relationship between subject and law enforcer contractual?	no ⁸	not necessarily	yes
Number of non-contractual law enforcement agencies that the system considers legitimate	1	unlimited	0
Number of contractual law enforcement agencies that the system considers legitimate	1	unlimited	unlimited
Are the law enforcers residual claimants of the area they police?	no	no	likely
Real world examples	modern governments	law enforcement in medieval Iceland; Pinkertons in 19th century America; bounty hunters in contemporary America	private police in Las Vegas casinos, Disneyland, and college campuses

At this point it may be useful to present a simple table representing the three major positions on law enforcement (Table 1). Combinations of these, as well as other major positions, can exist (see for example KERBER [2000a, p. 228]) but for simplicity this article focuses on these three.

The advocates of government monopoly believe that only one law enforcement agency, the government, is legitimate regardless of whether it is agreed to.⁸ Advocates of competition in the realm of law such as David Friedman believe that many law enforcement agencies should exist, financed by their customers but not necessarily agreed to by their subjects. Examples of systems with multiple law enforcers operating in one area are the Pinkertons in the 19th century American West and, to a limited extent, bounty hunters in contemporary America. The purchaser has a contractual relationship with the private police, but those subject to the investigation often have no contractual relationship with the police. These private police may do a good job tracking down people who have committed wrongs, but they are also criticized for making mistakes and inflicting harms on the wrong person (WHITE [1981, p. 402]).

Finally, the third group is not concerned with numbers but concerned with consent. To them the number of law enforcement agencies is limitless so long as individuals bound by them have *ex ante* agreed. Police not agreed to would lack authority to travel on someone else's property to enforce laws. Examples of proprietary community provision of law enforcement are seen in Las Vegas casinos, Disneyland, and on college campuses. Each of the proprietors has to cater to customer wants and has to offer a system of law enforcement that will please their customers. Unanimous agreement occurs because everyone who enters the gate basically agrees to follow the rules of the proprietor. If a person dislikes a specific community's rules he can go somewhere else and need not worry about being subject to a law enforcement agency against his will.

3 How Vertical Integration of Real Estate and Law Deal with Problems Compared to Other Systems

3.1 Proprietary Communities and the Internalization of Externalities

Private law enforcement bundled with real estate would deal with problems differently than systems where law is provided by a state monopoly or itinerant police. One of the main justifications of government's monopoly is to deal with externalities but proprietors with control over their community may be able to deal with externalities as well. Of course, some externalities are global and unless a proprietary community (or for that matter a traditional government) claimed jurisdiction over

⁸ Following BLOCK AND DiLORENZO [2000, p. 569–571] I do not classify either super majority or conceptual unanimity as found in BUCHANAN AND TULLOCK [1999] as contractual. A governing body that arose under conditions of actual unanimity would be classified as part of the voluntary-market sector rather than the coercive-political sector (BLOCK AND DiLORENZO [2001, p. 40]).

the entire globe, there will be many externalities and interregional conflicts that proprietary communities (or traditional governments) cannot solve on their own. Nevertheless, proprietary communities would be able to deal with many conflicts that take place at the local level.

Most of the dilemmas that classical liberals give to advocates of private provision of law only arise under the doubtful conditions of a world consisting of atomistic relationships. If neighborhoods contain residents who have not entered a restrictive covenant, they will be faced with many conundrums. ROTHBARD [1996, p. 222] took the bait as he wrote, "But suppose, as will sometimes will occur, two neighboring home owners get into a fight, each accuses the other of initiating assault or violence, and each calls on his own police company, should they happen to subscribe to different companies." As unlikely as a situation as this may be,⁹ in these circumstances, "Adjudication and resolution of disputes involve at least two parties, and create potential externalities" (COWEN [1992, p. 254]).

But despite the potential for externalities, COWEN's [1988] other work suggests solutions. If proximity of others posed potential problems, one should not be surprised to see private entities organize in such a way to "internalize these externalities." In a famous essay reprinted in COWEN's [1988] volume, DEMSETZ [1964, p. 25] describes how enclosing land into a single entity will enable the community to privately provide public goods "such as streets, sidewalks, refuse collection, and even police protection." Even if externalities exist within a geographic area, if the proprietor can exclude non-customers from a geographic area the externalities will be eliminated. Under such arrangements most of the problems of disputing neighbors who do not subscribe to the same law enforcement agency would be eliminated.

Proprietary communities would want to internalize both negative and positive externalities. Tying "public goods," such as law enforcement, with goods that must be purchased in a competitive market, such as apartments, will lead to the efficient provision of both (COWEN [1988, p. 10]). It would be surprising to see a shopping mall fail to hire security if needed. One would expect to see profit motivated developers and landlords following strategies that will increase the value of their property instead of building a residential area with one hundred unconnected units (if such an arrangement would encourage disputes between non-contractually bound neighbors). Tenants would be in a position to choose the package that they consider best and because landlords would be competing for tenants they would continually need to figure out the best way to package privately provided public goods (OSTERFELD [1983, pp. 341f.]). If it were optimal in a region for one hundred residents to have common security guards, then one would expect to see the landlord who has one hundred units in his complex to reap higher rents (FOLDVARY [1994]).

⁹ ROTHBARD [1996, pp. 221f.] wrote, "To get more specific: in the first place, as we have said, clashes would be minimal because the street owner would have his guards, the storekeeper his, the landlord his, and the homeowner his own police protection company. Realistically, in the everyday world, there would be little room for direct clashes between police agencies."

Currently in South Texas, the privately owned King Ranch is 1,300 square miles making it geographically larger than the nation of Hong Kong, the state of Rhode Island, or the cities of New York, Los Angeles, and Chicago combined. The optimal size of proprietary community is probably magnitudes smaller, but if one believes that even the median sized city is large enough to internalize a significant portion of externalities then we can imagine a proprietary community like King Ranch doing so too.¹⁰ Only the market could determine the optimal size of proprietary communities, but one can imagine proprietary communities picking their size based on how many externalities they want to internalize.

3.2 Post Contractual Opportunism When Real Estate and Law Enforcement Are Vertically Integrated

Our theory suggests proprietary communities would have an incentive to provide the optimal mix of local public goods, but would that not put customers in the exact same situation as citizens choosing governments? Given that transaction costs of moving exist under nearly every system, would the proprietors face the same incentives as government officials, which could include mistreating and taxing their tenants? Although TIEBOUT [1956] outlined a world where local governments provide the optimal level of public goods, his model does not consider the fact that people are unable to pick up and leave with their property in tow. CAPLAN [2001] shows that although residents can sell their homes, bad policies will be capitalized in housing prices, which gives local governments monopoly power to act against residents' wants. Applying similar reasoning to private law enforcement, SUTTER [1995] raises the possibility that private agencies would place restrictions on mobility thereby enabling them to extract resources from clients once they are locked in.

Many would consider the lack of political constraints on the law enforcers (as outlined by the constitutionalists), or the lack of competing police in the same area that customers could go to if they were dissatisfied (as outlined by David Friedman *et al.*) to be a problem. Without these checks it may appear that the dominant strategy for these proprietary communities would be to offer an attractive package to tenants and then disregard their interests after they have moved in. If one is convinced of the efficacy and necessity of government rules, one could imagine any number of middle-of-the-road policies where police were private but regulated by a higher government or somehow constrained by democratic institutions (HASNAS [2003]; KERBER [2000b, p. 147]).

Governmental rules, however, are often costly or impossible to enforce thereby giving one or more parties the ability to engage in post contractual opportunism.

¹⁰ A separate question is how this system could be adopted now that land is owned by large numbers of disparate individuals who have not signed restrictive covenants. Although the details are beyond the scope of this paper, this problem is similar to that faced by large developers who find creative ways of purchasing large plots or tracts of land (BENSON [2005]).

Stipulating all relevant contingencies in a contract and third party verification is often impractical or impossible (HART AND MOORE [1988, p. 755]), and even if a rule is well specified and enforceable, the mere threat of having to delay business to rely on some external review and enforcement gives one party the ability to engage in post contractual opportunism. KLEIN, CRAWFORD, AND ALCHIAN [1978, p. 300] point out that one way to overcome this problem “when specialized assets and appropriable quasi rents are present” is to have joint ownership of a production process so one owner cannot take advantage of the other.¹¹ One of the most important features of law provided by proprietary communities is that these two complementary services are vertically integrated, which changes the incentives of law enforcers dramatically. Because the landlord and the law enforcer are one and the same, as soon as the landlord stops providing reliable police the rent he receives from current and future tenants will decrease. In contrast to systems of government police or itinerant private police, with proprietary communities the enforcer of law is also the residual claimant on the value of the land. So to the extent that expropriation is a problem, it is *not* a cost imposed on tenants, it is a cost the proprietor himself would have to bear.

To illustrate how vertical integration and bundling can lead to efficient provision of two services even when consumers are “locked in,” let us consider one of the many analogues in the business world, since *ex post* opportunism is possible with any good that requires complementary components or service from the seller in future periods. For example, the value of computer hardware depends on the availability of software, so a proprietary system allows for potential *ex post* price gouging once consumers have purchased the hardware. In industrial organization this is known as the “hardware/software paradigm,” which asks whether the two goods that are dependent on each other will be produced at efficient levels (KATZ AND SHAPIRO [1994]). Although one might expect that it will be in the interest of a vertically integrated manufacturer to overprice the software after the hardware has been purchased, as FARRELL AND GALLINI [1988] point out, such a firm cannot charge exorbitant prices for the software without harming the demand for the hardware. Even with switching costs and potential lock-in problems, a would-be-monopolist must find ways to commit to not gouging buyers *ex post*. Otherwise, he will see little demand for his product in the long run.

Similarly, the proprietary community provides both the physical building (hardware) and the service of security (software), but because the value of a property is dependent on the availability of security, the landlord will have to think twice about using his law enforcers to extort his residents. Even though there are costs of moving and potential for lock-in, the landlord needs to commit to service or he

¹¹ The private sector has found many ways to structure business relationships to make agreements self-enforcing, so the question is to what extent these principles can be applied here. Businesses use differing ownership structures, bonding, and reputation mechanisms to induce contractual compliance (BOOT, GREENBAUM, AND THAKOR [1993], KLEIN AND LEFFLER [1981]; TELSER [1980]; WILLIAMSON [1983]). Proprietary communities might attempt to use any of the above mechanisms so they could make their property more attractive to prospective tenants.

will not find tenants. Proprietors may be able to make a credible commitment in a number of ways. Katz and Shapiro outline how this is done with hardware and software:

“[One] way for the network sponsor to assure customers that they will not be held up in the second period is by renting rather than selling hardware. By renting, any capital loss associated with hardware due to a high price in software will be borne by the hardware vendor, not by the end user. Vertical integration can also serve as a commitment to supply both hardware and software.” (KATZ AND SHAPIRO [1994, p. 103])

This is essentially the suggestion of advocates of land-lease planning such as MACCALLUM [1970], [1997], [2002], FOLDVARY [1994], and DENG, GORDON, AND RICHARDSON [2002]. Under these arrangements the property owner would be the residual claimant, so unlike CAPLAN’s [2001] Tiebout governments gone awry, the proprietor would have an incentive to provide the best bundle of security, otherwise *his* property value would decrease.

Consider for example a landlord who decided to build a Berlin Wall around his property. This would quickly cause rents of the grounds to plummet, and unless he could build very quickly he would have no tenants left to mistreat. This problem would become even more unlikely if proprietors owned multiple noncontiguous communities. Assuming a landlord had the ability to expropriate tenants in one, doing so would quickly result in the loss of business in all others. Unless he was able to commandeer from all of the properties at once, an inconsiderate landlord would face significant losses. These concerns will provide significant incentives for proprietors to provide the best security for their grounds. In contrast, public police are not residual claimants in the regions they control, so they may have little problem skimming rents from property. This fits with BENSON’s [1994] public choice account of the rise of public policing as a means of enhancing revenue for the state.

One possible solution is to unbundle police from real estate, which is essentially the proposal of David Friedman; another possible solution is to keep the two bundled, but to privatize the police, creating a vertically integrated private community. To the extent that each proprietary community can be considered a resource monopoly, industrial organization demonstrates that a joint monopoly will charge less than two monopolies (SHLEIFER AND VISHNY [1993]). To the extent that proprietary communities are competing to attract residents, both the real estate and the security should be provided at efficient levels. The fact that the security is tied to the property should not be detrimental to customers at all. One should be no more concerned about shopping malls providing security than shopping malls providing restrooms. If an entity other than the mall owner, such as government, had a monopoly over the provision of restrooms, one might expect it to price the restrooms as if collecting tolls. One solution would be to abolish the monopoly and allow any entity to build a restroom anywhere on the property; another, perhaps more sensible, solution would be to give this function back to the owner of the shopping mall. There may be many ways to prevent holders of a monopoly over the use of force from mistreating

their clients (and it would be unrealistic to pretend to be able to predict all of the successful mechanisms here),¹² but bundling law enforcement and real estate seems to be an economically sensible mechanism.

3.3 *Dealing with Interregional Disputes*

According to the above arguments, we should not expect enforcement agencies to mistreat their customers, but this says little of how agencies would behave toward other proprietors because they are not residual claimants on others' land. If an aggressive proprietary community could expand its territory by conquering neighboring communities, society would be left with an entity that arrogated a monopoly in the use of force, *i.e.*, a government. Before answering the question of how proprietary communities would deal external disputes it must be stated that one can accept the arguments for private police at a local level yet be pessimistic about whether they can peacefully coexist without government oversight or whether they can fend off external aggression (HOLCOMBE [2004]).

One might deal with interregional challenges in at least three ways. The first response, as put forth by KERBER [2001, p. 181], is that competing local jurisdictions could deal with concerns at the local level but some type of federal government would be needed to deal with concerns at higher levels. According to KERBER AND HARTIG [2000, p. 342] a federal government would provide the metarules or the basic framework within which competition will take place.¹³ This proposal in line with HASNAS's [2003] compromise solution that would make law enforcement private but allow for the possibility that it would be regulated from above. This benign federal government would step in if a local jurisdiction or a foreign government overstepped its bounds, but the federal government would not do much more than that. So even if one is convinced of the necessity of national defense or a federal constitution, one could still advocate private police at the local level. All of this, however, at least partially assumes that government works to advance the public good, an assumption that HOLCOMBE [2004] and LEESON AND STRINGHAM [2005] question.

A second response is the possibility that proprietary communities could voluntarily join private networks to deal with interregional concerns (STRINGHAM [1999, pp. 61–64]). Such a system would contain some parallels to KERBER AND VANBERG's [1995, p. 55] proposed multi-layered structure of jurisdictions where local jurisdictions would have contractual relationships with higher level organizations to

¹² If tenants lacked trust in vertically integrated proprietary communities, they could require them to be bonded with third parties who would pay compensation if landlords broke contracts. The bonding company could be located on the other side of the world if people worried that a proprietary might expropriate the bonding company. Admittedly, the bonding company must be trusted, but BENSON [2000] demonstrates that numerous international (and trustworthy) agencies like this already exist. Arbitration companies do not cheat their customers because cheating is against their interests. If the workability of this system hinges on this problem, it can be solved.

¹³ I thank two anonymous referees for stressing the possibility of these positions.

deal with interregional externalities. The important stipulation compared to existing federalist structures such as those described in BUCHANAN [1995] would be that jurisdictions be private and all associations between jurisdictions be voluntary with a right to secede. Introducing cooperation between communities does bring the possibility of collusion suggested by COWEN [1992], although a network of proprietary communities need not coordinate as much as multiple police in one local jurisdiction so the potential for collusion might be less. CAPLAN AND STRINGHAM [2003, pp. 313–316] maintain that just because firms can cooperate on certain margins (such as standardizing products), does not mean they can cooperate on all margins (such as creating a cartel), so whether a network of proprietary communities should be a cause of concern is unclear.

The third response is that just because interregional conflicts exist, does not mean a federal government, a world government, or even a private network has the capability of solving them. Comparative institutional analysis often demonstrates that no solution is better than a misguided cure (DEMSETZ [1969]). With the exception of advocates of world government, interregional aggression poses problems to any system and, as TULLOCK [1974] points out, even world government would not eliminate the problem of internal conflict. The question is what system will lead to fewer disputes. Authors such as HUMMEL [1990] and LIPSCOMB [1913, p. 90] maintain that the dissolution of governments and their tax financed militaries would actually lead to less conflict. Could independent proprietary communities peacefully exist without being regulated from above? The proprietary communities proposed here would essentially be like private “nations,” so if one believes that independent nations can coexist without being regulated by a federal or world government, then it might be possible for proprietary communities to coexist without being regulated from above.¹⁴

Whatever position one takes about the proper solution for interregional disputes or national defense, one can still accept that private police can be privately provided at the local level. Proprietary communities would not solve all of the world’s problems, but if they have the ability to more effectively deal with conflict at the local level, they could be judged as a marked improvement.

4 Conclusion

This paper has attempted to show that law enforcement need not be provided by a government monopoly or by multiple private law enforcers in each region. Instead law enforcement can be provided by profit motivated proprietary communities

¹⁴ Why do current nations not expand further and what would prevent a proprietary community from taking over others? A more in-depth analysis of international defense is beyond the scope of this paper, but some answers may be provided by work on civilian resistance such as HUMMEL [1990], [2001] and SHARP [1970]. Hummel argues that the law ultimately relies on the support of a large number of people, and as COWEN [1992, p. 257] writes, “A large enough group of individuals and institutions, acting in concert, can impose their will upon any political system.”

that bundle law with real estate. If one can imagine nations with different jurisdictions, it is not hard to imagine private “nations,” *i.e.*, private parcels of land, with different jurisdictions. Classical liberal arguments against competition in a given area may rule out a system with unlimited entry, but they do not rule out a market based system composed of proprietary communities.¹⁵ Instead of a having a “compulsory monopoly of defense services over some arbitrarily designated territorial area,” (ROTHBARD [1977, pp. 2f.]), the monopoly would be over a *well-designated territorial area*, specifically that defined by property owners.

Proprietary communities as residual claimants have an incentive to have their land well policed because they would lose revenue if their customers were unsatisfied. Law enforcement provided by proprietary communities differs from public police or itinerant private police who may not have the interests of their subjects as their number one concern. One of the purposes of this essay to show that even if one accepts the crux of the arguments in Cowen, Sutter, and Nozick, a market based system is still possible. In this vision of a market system, Nozick’s criticisms do not apply because there would not be itinerant police with potentially risky practices, nor would Cowen and Sutter’s criticisms apply because there would not be multiple firms acting in concert through a network. Thus one can accept much of the classical liberal arguments but reject the conclusion that government police are necessary.

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¹⁵ At least in this author’s opinion, the final section of NOZICK’s [1974] *Anarchy, State, and Utopia* is entirely consistent with the system proposed here.

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