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

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Abstract

Stringham's (2006) analysis of vertically integrated proprietary communities suggests that private monopoly landlord/law enforcers overcome the obstacles to functional market anarchy. I argue that while innovative, Stringham's solution does not work. A monopoly landlord/law enforcer maximizes profits by optimally extorting his tenants in violation of voluntary contracts. The result is a predatory rather than voluntary system.

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1 Introduction

Edward Stringham's (2006) insightful paper, "Overlapping Jurisdictions, Proprietary Communities, and Competition in the Realm of the Law," sheds important light on the functionality of private property anarchy. Stringham argues that vertically integrated proprietary communities are an overlooked and viable alternative to both traditional government provision of law and its enforcement, and competing private agencies of legal enforcement.

The core of his argument is straightforward. According to Stringham, critics of market anarchy, such as Cowen (1992), Sutter (1995), and Nozick (1974), rightly note the difficulties of competing law agencies within a geographic area. As they point out, it is unclear how such a system would deal with third parties. Although an individual may contract with a law enforcement agency for his protection, inevitably, enforcement will involve imposing the laws agreed to by this individual and his agency on some other person who has not contracted with the agency and is not bound by its rules. In response to this problem, Cowen and Sutter (1999, 2005) point out that agencies are led to fight one another, creating a Hobbesian jungle scenario, or collude, forming a *de facto* government.

Stringham's innovative solution to this problem is a hybrid system that ostensibly creates purely contractual law enforcement arrangements, retaining private property anarchy, but allows for territorial monopolies as the providers of legal enforcement. Each proprietor creates rules for his residents and provides them policing and other public goods. Individuals have the choice of whether they want to contract with the proprietor, which means submitting to his association's rules, etc., or not. Under this system, Stringham indicates, the issue becomes one of whether monopoly proprietors will behave peaceably toward their customers, abiding by the terms of their contracts, or will behave in a predatory fashion, expropriating their tenants.

I commend Stringham's thinking. However, I do not believe the critical issue he identifies—that of proprietor predation—is solved by the system he proposes. In this brief comment I point to the crucial obstacle that prevents monopoly proprietary communities, described by Stringham, from working.

2 The Problem of Force

According to Stringham, profit-motivated monopolist law enforcers will not expropriate their customers. The reason for this, he suggests, is that in a vertically integrated proprietary community the landlord and law enforcer is one and the same. Consequently, the landlord is the residual claimant on the value of his property, which depends upon how he treats his tenants. Any *ex post* contractual opportunism on his part, such as demanding tenants to pay a "tax" not specified in their original agreement, drives current tenants away and makes his community less attractive to future tenants. This loss is capitalized in the present value of the proprietor's community, the cost of which he incurs. To avoid such losses, proprietors comply with the contracts they negotiate with their tenants.

There is a problem with this argument. Namely, the claim that proprietors maximize profits by *ex post* contractual compliance does not follow from the fact that landlords/law enforcers are residual claimants, as Stringham suggests. Recall that a landlord in this system has a monopoly on force in his geographic area. This means that he is the strongest agent in is territory. To be a successful landlord/law enforcer, the community proprietor must be stronger than anyone else in his community. If he is weaker, he cannot enforce the rules of his community. In this case, the proprietor could not successfully prevent/punish rule violators from plundering others in the territory, so no one would want to patronize his community. The proprietor's monopoly on force in his geographic area is what allows him to overcome this problem. It creates a sufficient strength disparity in his favor over others such that the proprietor is able to enforce the rules that govern his community. Thus, to have a monopoly on force in one's geographic territory is to be the strongest agent in that territory.

This is problematic because it means that the landlord/law enforcer in Stringham's system is strong enough to take what he wants from others with little or no resistance. His strength superiority makes it cheaper for him to use extortion than trade to obtain what he wants. The strength disparity resulting from the proprietor's monopoly creates a time inconsistency problem for his incentives before and after contracting voluntarily with tenants.

Pre-contractual agreement, when a proprietor does not yet have a monopoly on force over anyone and so is not yet strong enough to extort them, the proprietor finds complying with the contract *ex post* profit maximizing for the reason Stringham cites. But once the agreement has gone into effect and the landlord's monopoly on force is established, contractual compliance is no longer in his interest. Given that the landlord has established a strength disparity in his favor through the contractual process, he now finds it cheaper to take what he wants from his tenants by force than to interact with them peaceably.

The fact that the landlord/law enforcer is a residual claimant on the value of the community does not alter this. If tenants were free to exit the community, like patrons are free to stop buying from restaurants when they receive bad service, then residual claimancy would be an effective check on the proprietor's behavior. But force is not like a meal one receives at a restaurant. A restaurant owner has no monopoly on force, and thus no power to prevent dissatisfied customers from refusing to patronize his restaurant. Stringham's monopolist landlord/law enforcer, however, is quite different in this regard. His most notable characteristic is his monopoly on force that makes him the strongest agent in his territory. Unlike a restaurant owner, his monopoly strength superiority gives him the power to prevent dissatisfied tenants from exiting.[1] Because the proprietor can extort his tenants without losing his tenant base, some positive level of extortion is profit maximizing. In this way, his monopoly on force creates the unique time inconsistency problem pointed to above.[2]

Of course this level of extortion is not without limit. A monopoly proprietor would not, for instance, find it in his financial interest to expropriate 100 percent of his tenants' produce. At this level of expropriation his tenants would have no incentive to produce anything, leaving nothing for the proprietor to take. But neither would the proprietor's optimal level of expropriation be zero. A monopoly landlord/law enforcer faces the standard revenue extraction tradeoff reflected by the Laffer curve. He is in the

[1] It is true that the proprietor may lose future tenants, but this does not affect his ability to extort current ones. If the community is 'full'—has reached maximum capacity, his ability to keep existing tenants under his domain means that losing future rents imposes no cost on him at all.

[2] Note again that this time inconsistency problem does not exist when consumers may freely exit, as they can with restaurants. The threat of lost business aligns the restaurant owner's incentives *ex ante* and *ex post*. But if he has a monopoly on force that enables him to prevent consumers from exiting, such as Stringham's monopoly landlord/law enforcer, his *ex ante* and *ex post* interests diverge. Although it is profit maximizing for the restaurant owner to behave honestly *ex ante*, given his coercive monopoly, it is profit maximizing for him to extort his customers, who cannot exit, *ex post*.

position of McGuire and Olson's (1996) "stationary bandit" who maximizes his income by taking some, but not all, of the product of those under him. The monopolist proprietor will extort his tenants up the point at which the marginal deadweight loss from extortion equals the marginal value of the resources he is able to extract (McGuire and Olson 1996: 76).

Importantly, this outcome is not only a theoretical possibility, but historically is in fact what we observe. The system described by Stringham is not far off from monarchial systems used in pre-modern Europe. Monarchs were effectively monopoly proprietors of vertically integrated communities much like Stringham describes. They owned their geographic territories and were residual claimants on this land. They were also the territory's landlord and law enforcer. It is true that they did not contract with their subjects *ex ante*, but it would make little difference if they had. Regardless of how they created their monopoly on force, once it was established it was in their interest to expropriate their citizens to some extent. The history of monarchs is replete with examples of this. Significantly, extortion occurred despite the fact that as proprietors of their kingdoms, monarchs capitalized the losses of expropriating their citizens. This is because some positive level of expropriation is optimal under such conditions—i.e., revenue maximizing for the monarch—as described above.

The same is true of the various nobles in some kingdoms, who during the feudal period, for example, operated manorial systems. These feudal lords were landlords/law enforcers for their serfs who worked for lords in return for protection and other public goods. But feudal lords are not especially known for their kindness and respect toward their serfs. On the contrary, they routinely extorted their serfs to their advantage.

The key point is that once a landlord has established a monopoly on force through contract with his tenants or otherwise, his strength superiority enables him to prevent tenants from exiting. He is then in a position to extract resources from tenants beyond those voluntarily agreed to in the original contract, and finds it in his interest to do so. Stated differently, the threat of losing customers is only a cost to business owners who can in fact lose customers by behaving dishonestly. But, as pointed out above, for a business owner who has a monopoly on force, this is not the case. Since he benefits from extorting his "customers" but incurs no cost in terms of lost "customers" by doing so, it is in the interest of a business owner with a monopoly on force to engage in optimal extortion.

3 Concluding Remarks

The project of pushing the bounds of the market is an important and useful one. If for no other reason than the fact that governments, in a great part of the world, are too weak or unwilling to act as effective legal enforcers, understanding how such enforcement might be achievable under anarchy is a critical task.[3] Stringham's (2006) piece is very valuable in this regard.

Nevertheless, like those before it, Stringham's proposal confronts a significant obstacle when it comes to dealing with the issue of force. A monopoly agency of force of any kind—government or private proprietary community—suffers from the fact that in the end, the monopolist is in a position to take advantage of those who are weaker than him. Given his monopoly, this is everyone else in the monopolist's territory. This is not

[3] For a historical illustration of an alternative market mechanism for dealing with the problem of force under anarchy, see Leeson (2006).

to say that the problem of force is insurmountable. On the contrary, there is good reason to think that the market can in fact solve this dilemma. But additional research is required to demonstrate that this is so.

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