

## BOOK REVIEWS

### **Social Contract, Free Ride: A Study of the Public Goods Problem**

Anthony de Jasay

London: Oxford University Press, 1989, 262 pp.

In the textbook models, even selfish men who lack any feeling for nation or community will obey the political authority because of their dependence on the government to supply certain essential goods and services. Civil order, national defense, and a clean environment are prominent examples. These so-called “public goods” are unique in that their consumption is nonexclusive. Once they are supplied, everyone, even those who did not contribute to their purchase, will benefit from their existence. Thus, it is generally argued that if individuals are not forced by the state to contribute to the cost of such goods, each will prefer to let others bear the economic burden of supplying the good while he enjoys a free ride. The received view is epitomized in Hobbes’s classic dilemma. Either the supreme public good or internal and external security is not provided (sufficiently), or there is a provider with the power to tax those who benefit to pay for the good. That is, in the provision of internal and external security as well as other public goods, we must choose between anarchy or coercion. Hobbes assumed that people are so afraid of what they might suffer in uncoerced chaos that a powerful state is accepted as the best of a bad set of choices. Theories of social contract thus are assumed to legitimize the state without introducing a normative premise.

Anthony Jasay’s new book, *Social Contract, Free Ride: A Study of the Public Goods Problem*, is unusual in that it starts from the nature of contracts and games and provides a radically new understanding of social coexistence. In doing so, Jasay offers a novel account of the public goods dilemma and dismantles the conventional theory.

Without relying on any assumptions about “man’s better nature,” Jasay deduces that the pursuit of maximum utility is sufficient to induce groups of rational individuals spontaneously to allocate among themselves, however “unfairly,” the cost of the public goods they value highly. This is the main message of Jasay’s book. In Chapters 1 through 7, a strict utility-maximizing approach is used. Further possibilities, using various moral motivations, are admitted in Chapter 8.

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The standard approach to public goods problems uses some form of the “prisoners’ dilemma,” where uncoerced contribution to the public good is irrational. In these standard explanations, when the “productivity” of public provision of a good is sufficiently superior to private-sector substitutes, incentive structures arise whose normal solution is that some people contribute and others free-ride on the public good thus created. Without government intervention, social roles are self-selected—those who pay for the good are “suckers,” others are free-riders. Alternatively, this standard approach allows social roles to be imposed by “social contract,” in which case everyone will contribute (typically through taxation).

According to this prevalent view, the primary role of the state is to ensure that the distribution of public burdens and benefits is decided by collective political deliberation rather than by the free interactions of autonomous individuals. In the domain of collective choice, in the nonmarket provision of goods and services, benefit and individual contribution are uncoupled. The point of the system is to make selected goods and services freely available, to help some members of the public at the expense of others. Benefit and contribution remain linked only for aggregates (the nation or the town), not for individuals. In this way the state turns into a redistributive engine *par excellence*. Through the political process, the “public” determines which aggregates will get what “public goods,” and who will pay for the provision of these goods. Jasay, with impeccable logic, shows how and why that solution is unsatisfactory and why this naive quest for “fair” distribution is bound to fail, bringing about chronic overconsumption of public goods and stimulating the free-riding it was meant to prevent.

Jasay demonstrates that the standard explanation for the provision of public goods is but a special case among several other possible incentive structures or “games.” The true role of the state is not, as we have been taught, forcibly to channel resources into the production of public goods that would not otherwise be available. Standing in contrast to the accepted collective form of decisionmaking is the market. In the domain of individual choice, any individual’s benefit is firmly linked to his own contribution. The market order works on this principle.

In *The State*, an earlier book that is now starting to exert some influence, Jasay presented a theory of how the natural conflict between state and society transforms both in a process from which only historical luck allows us to escape.<sup>1</sup> The emergence of a relatively free society, the rise of the West, is the result of happy accidents in history, and the free society is a rare and endangered species. In *Social Contract, Free Ride*, Jasay reinforces this message by requiring us to face the prospect that even our constitutional-liberal doctrines are not liberal enough to protect us from the unintended and automatic crowding out of individual choice by collective will.

<sup>1</sup>Anthony de Jasay, *The State* (Oxford: Blackwell, 1985). James Buchanan commented on *The State*, “de Jasay is, for me, a real discovery.” (Buchanan, “Review Article: From Redistributive Churning to the Plantation State.” *Public Choice* 51, no. 2 [1986]: 241.)

Though Jasay claims that the Hobbesian dilemma is spurious, he identifies a *practical* public goods problem emanating from the opposition of the two great competing principles of classical liberalism and socialism. The gist of classical liberalism in the public-political sphere is to give priority to individual freedom, to private options. The principle advises us to maximize the domain of individual choice.

The rival principle of socialism gives priority to “social justice,” to reducing the pain of envy, to what is succinctly expressed by the Marxian phrase, “From each according to his ability, to each according to his need.” The socialist principle urges us, in the context of the large, anonymous society, to reintroduce the norm of “solidarity” and mutual dependence that stabilized the hunter-gatherer horde for more than a million years and that is used today to stabilize small face-to-face groups. Proponents of the solidarity norm apparently fail to understand (or they do not mind) that reinstalling such a social system in the current large, anonymous society inevitably would lead to a totalitarian regime. Hence, those who have adopted socialism make great efforts to maximize the domain of collective choice, and in doing so, they automatically reduce individual freedom.

On the level of institutional arrangements, the principles of classical liberalism and socialism are reflected in two very different methods for solving coordination problems within society and providing needed goods and services: the market order and the command order. The market order is characterized by individual choice, freedom of contract, consumer sovereignty, and the individual’s answerability for his decisions. The collective provision of goods and services is directed either toward redistribution in accordance with the principle of socialism or toward solving the Hobbesian public goods dilemma.

Jasay points out that mixing the institutional arrangements of a market order with those of nonmarket (or public) provision of goods and services “determines the character of a society more decisively than anything else in the political sphere.” This claim is analogous to Karl Brunner’s thesis of “the ambivalence of the political structure.”<sup>2</sup> Every political structure is a mix of positive sum social games (i.e., productive activity and trade) and of negative sum social games (i.e., activities concerned with redistribution). This mix exists in every situation, in anarchy no less than in a politically structured society. The decisive difference between anarchy and a politically structured society lies in the methods used in the negative sum social games.

In anarchy, that is, in the absence of a single contract enforcer, the method used for redistribution from others to oneself is robbery. The efforts to protect oneself against the redistributive efforts of others are private methods of defense against robbery. In a politically organized society, both the methods used to redistribute resources from others to oneself and the defense against such attempts by others are those of the political process. Brunner’s considerations prove useful in the analysis of the problem of public goods.

<sup>2</sup>See Brunner, “The Poverty of Nations,” *Cato Journal* 5 (Spring/Summer 1985): 40–48.

There are many allegedly “public goods,” like health and education, for example, that are not inherently indivisible, but can either be divided up into individually consumed bits or gathered into large aggregates. These goods thus can be assigned either to individual choice or to collective choice. A society  $x$  tends to be more free than a society  $y$  if, with respect to inherently divisible goods, in  $x$  less recourse is taken to nonmarket provision of such goods and services than is the case in  $y$ . Insofar as a society adopts the principle of classical liberalism, it will not assign any inherently divisible matter to collective choice.

There are, however, some inherently indivisible matters, some intrinsic public goods. Hence, even in the freest of societies, there will be a domain of collective choice. We can call a choice “private” if its impact on others is negligible. All other choices are then “nonprivate choices.” A nonprivate decision that is made for the individual(s) by others is collective in the broad sense, independent of whether it is made by a single person, a committee, or a majority. Decisions are collective in the narrow sense if they are made by the set of persons concerned or directly affected, that is decisions made collectively by individuals for themselves, so to speak.

Jasay points out that a constitutional rule guiding collective choice is of use only in cases of nonunanimity. Therefore, recourse to constitutionally based rulemaking indicates the recognition that there will always be individuals who dislike the decision reached in collective choice. In a cost-benefit analysis, however, these dissatisfied individuals may find it less costly to live with the disliked decision than to emigrate or to make serious efforts to change the constitutional rule in question. It appears unnecessary to invoke a social contract theory based on the idea of unanimity, however, to legitimize a collective choice.

Since even in the freest of societies there is a domain of collective choice, a question arises about which procedures should be used in making such decisions. A constitution can be viewed as a system of rules for collective choicemaking. Within the domain of collective choice, various decision rules are possible, and the constitution stipulates the particular rule that will be used in the society to which that constitution applies.

The decision rules among which societies choose can be described in various ways. One particularly useful description classifies these rules into voting and nonvoting procedures, and then the subset of voting procedures is divided into democratic and nondemocratic voting procedures. It is not easy to explicate the concept of “democratic voting procedure in the domain of collective choice,” however. An approach I find fruitful is first to identify an extreme or ideal type of democracy—“head counting” or unqualified franchise without any restrictions (not even age) in combination with bare majority rule (50 percent plus 1 vote). Then we can introduce a comparative concept. To say that “ $x$  is more democratic than  $y$ ” relays information about the comparative closeness of the constitutional rules “ $x$ ” and “ $y$ ” to the ideal type. In this way, we can identify a dimension on which voting procedures in collective choicemaking range from extremely democratic to plutocratic.

The benefit of the democratic method is that (when unqualified franchise is practiced), it permits everyone to participate to some extent, even if only to one  $x$ -millionth part. Theoretically, even though such participation is less desirable than making decisions on one's own, it is still better than not having even an  $x$ -millionth part in the decisionmaking.

But it transpires that the democratic method just described cannot provide a guarantee against totalitarianism. The extreme or ideal type of totalitarianism may be defined as an order in which no sphere of the individual's daily life is immune from state interference, in which the protected domain of private choice is insignificant. State interference is total. The customary definition, which invokes auxiliary concepts such as ideology or doctrines about the identity of Throne and Altar, of worldly and spiritual power, of State (or leader) and society, introduces elements of the arguments that totalitarian regimes use to legitimize their system. It appears preferable not to mix the description of such systems with the arguments used in attempts to legitimize them or with explanations of their origin.

Having identified the extreme type of totalitarian system, we can construct a continuum of regimes that runs from freedom to slavery, and a consequent comparative concept of a free society. A society  $x$  is more totalitarian, that is, less free, than a society  $y$  if  $x$  is closer to the extreme type of totalitarianism than is  $y$ . The degree of totalitarianism is, of course, independent of who rules—a single person, the central committee of the Party, or shifting majorities in an unlimited democracy.

Every method for collective choicemaking and hence every constitutional rule has a built-in bias favoring particular identifiable interests. This must be so since, as Jasay convincingly argues, any rule of collective choicemaking is useful only in cases of *nonunanimity*, and any rule adopted has a probabilistic propensity to produce one type of outcome rather than another. If the method is used only once or a few times, any outcome is possible. But the longer the period over which the operation of a particular constitutional rule is observed, the more pronounced and visible its built-in bias will become. The more closely the voting rule approaches the extreme form of democracy described above, and the longer the period over which the rule is observed, the more the domain of collective choice will grow. This result follows because the political process will be used both by free riders seeking to achieve their aims and by individuals seeking to defend themselves against free riding by others. The groups attempting to defend themselves can only do so through the political process.

The more a constitutional rule approximates the extreme form of democracy, the more it will tend not only to enlarge its own domain, but also to level out rewards. As an unintended consequence, it will reduce efficiency and wealth creation by encouraging investment of resources and efforts in the political process rather than in the free-market process. The tendency to leveling is illustrated by the well-known dynamics of income transfers within the middle classes, typical of the interest group welfare state.<sup>3</sup> The transaction

<sup>3</sup>See Gordon Tullock, *The Economics of Wealth and Poverty* (Brighton, England: Wheatsheaf Books Ltd., 1986), pp. 119ff.

costs of the bureaucracy will increase correspondingly. Politicians will use the rhetoric of "solidarity" to prevent comparisons between collective solutions to problems and private choice solutions to the same problems.

If, as Jasay argues, the Hobbesian dilemma could be overcome by spontaneous arrangements, the trend toward the reduction of freedom that has been prevalent in Western democracies in the 20th century could be stopped and perhaps reversed. But to do so would involve a restructuring of some of our basic institutional arrangements, and that would require a preceding change in the climate of opinion, something that is not likely to happen.

There have been many attempts to reverse the trend toward ever larger government. Of recent historic importance are the efforts of the Reagan administration and of Margaret Thatcher's government. But there are others. For example, the Labour Government in New Zealand has embarked on a program of deregulation, privatization, and microeconomic reform unheard of in such a short period of time. Nonetheless, the success of these efforts so far remains limited.

Thus, Jasay asks, why do contemporary societies end up with an ever-expanding state *even* when they claim to prefer less government? That is, the arena of collective choice generally continues to grow even when voters have indicated they want less government and the elected officials have made efforts to reduce public provision of goods. There is, of course, an enormous literature, encompassing several competing theories, devoted to trying to explain the growth of government. Almost all of the competing theories identify as an important factor systematic misinformation provided to the public about the actual costs of providing public goods, of imposing regulation, and of engaging in inflationary finance. Jasay's explanation—an "explanation of principle" in Hayek's sense—is couched in terms of his theory of public goods, which is founded on solid game-theoretical arguments. His explanation constitutes intellectual progress, and his theory can also guide us in our search for remedies.

According to Jasay, the standard approach to public goods problems sees two possibilities. Both appear unattractive: Either (a) no public goods can be provided sufficiently, or (b) social roles of taxpayer and tax beneficiary are imposed by an alleged "social contract"—everybody is coerced to contribute to *all* public goods. Public goods problems are conceived as typically "prisoners' dilemmas." Jasay shows that there are other possible incentive structures or "games." If the "productivity" of public provision is sufficiently superior to private-good substitutes, the risk of its failure may outweigh the attraction of free riding on its success, where both failure and success are weighted by their subjective probabilities. These probabilities vary with what each expects the others to do. Jasay thus finds that the prisoners' dilemma is transformed into a radically different "game," where it is rational for some to contribute even if others free ride on the public good thus created. The diagnosis of this potential game situation permitting *voluntary* cooperative solutions is *the core novelty of Jasay's public goods theory*.

Under his solution, the social roles of "sucker" and of free rider are selected by the individuals themselves. However, free riding is resented by the

suckers, who regard it as “unfair.” If, in order to suppress this “unfairness,” society opts for the coercive solution, not only is there more coercion but, more importantly, free riding is reintroduced, now in the form of overconsumption of certain public goods and redistribution of the incidence of taxation.

For at least 75 years, individual freedom has been on the decline worldwide. Probably for the first time in our century, at any rate for the first time since the New Deal, more-than-rhetorical freedom has gained some ground in important countries of the political West. Yet even the success of Reaganomics and Thatcherism has been very limited.<sup>4</sup> The countries of the political East, which with their devotion to socialism have found themselves lagging farther and farther behind the capitalist world, are now making efforts to increase the efficiency of their economies. For the Soviet Union, the need for reform is particularly pressing. Without improving its economic performance, the Soviet Union cannot hope to retain her status as a military superpower. As they attempt to improve the efficiency of their economies, the Eastern bloc countries cannot avoid introducing more freedom as well. However, the final outcomes of recent developments in the USSR and in China remain an open question.

The continuing growth of government is alarming because of the loss of individual freedoms that inevitably follow such growth. Freedom is primarily a characteristic of an individual’s social life; a society is a society of free individuals insofar as it respects the right of the individual to live his own life, to pursue the “happiness” he subjectively values. Classical liberalism has taken a first step toward an explication of that ideal by identifying freedom as the individual’s right to noninterference. That is, classical liberalism conceives of freedom as individuals’ immunity from coercion—be it coercion by others acting individually or by the state—that is not necessary for securing similar rights of noninterference for all others within the society. But this approach leads to the problem of how to define “necessary coercion” in such a way that the definition offers a clearly objective method for ascertaining which coercive acts of the State are truly necessary and which are not.

This poses a problem that can be solved only by recourse to a theory of rights—in particular, a theory of “option” rights. The more recent use of expressions such as “welfare rights” or “social rights” distorts the word “right” and undermines the idea of what it means to have a right. An option right places an obligation on *all* others not to interfere with that right. By contrast, a so-called “welfare right” is a demand directed to unspecified addressees who may well be unwilling or even incapable of meeting the demand.

The approach of classical liberals like John Locke, William Blackstone, Adam Smith, and Friedrich von Hayek to the problems of social order explicitly faces the value issue. By contrast, contract theory, by attempting to sidestep the value issue, camouflages it. The key tenet of the latter approach is the contrary-to-fact statement that there is a social contract proposal so that

<sup>4</sup>See Milton Friedman, “Has Liberalism Failed?” In Martin J. Anderson, ed., *The Unfinished Agenda* (London: Institute of Economic Affairs, 1986), pp. 127–39.

rational agents who have examined the proposal would, after having engaged in a cost-benefit analysis, conclude that it is rational to accept the proposal. That tenet is not falsifiable, however; it does not contain any empirical information.

Having to some extent clarified the aim of contemporary classical liberalism as attempting to reverse the current trend toward growth of government, we can proceed to search for appropriate means to that end. The means that first come to mind are, of course, constitutional limitations. It is relatively easy in principle to state the two key ideas of a Constitution of Liberty. (1) Minimize the domain of collective choice. This will at the same time reduce the temptation to refer matters to the political process in an effort to further one's own interests. That is, limiting the range of collective decisions will reduce the incentives to invest in the political process (the negative sum social games) rather than in private productive activities (the positive sum social games). (2) In the domain of collective choice that is unavoidable, make use of the democratic methods that are most compatible with the aims of a free society. As already mentioned, there are a variety of democratic methods, and their relative merits can be appraised only after a systematic performance comparison. A proposal that lies close at hand is making the right to vote dependent on qualities that are relevant to the collective decision that is to be made. This proposal, however, is difficult to make operational when the collective decision concerns only the delegation of rights to certain selected individuals. Nonetheless, a general requirement that suggests itself is that the voters have "sufficient" experience of life. Such experience can come only from having, for some period of time, engaged in some productive activity, that is, from having participated in the positive sum social game characteristic of a society based on the division of labor.

The practical task is how to make a Constitution of Liberty into a *living* constitution. Again the solution, in principle, lies close at hand. We need to create a clientele whose interests are to return to and to preserve limited government. But how do we create such a clientele? One necessary condition for developing the necessary incentives to attempt to reduce the growth of government is an understanding both of the functioning of an economy and of a political order. Hence, an important part of the task is educating the general public, in particular the younger generation who must carry the torch of freedom. That sufficient demand for a public good like national defense can be created on a voluntary basis may appear counterintuitive. Yet Jasay's game-theoretical arguments are impeccable. Jasay's two books are choice examples of the successful application of the economic approach and of game-theoretical arguments in political science and political philosophy. They bring a breath of fresh air to both fields, and they make an important contribution to the educational task.

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**Private Money: The Path to Monetary Stability**

Kevin Dowd

London: The Institute of Economic Affairs, 1988, 66 pp.

Is there anything inherently special about what we call “money” that dictates its supply should be provided by a monopolist? Kevin Dowd, a lecturer in economics at the University of Nottingham in England, addresses this question by utilizing a Public Choice framework to analyze monetary policy. He concludes unambiguously that the answer is “no.” Once government is involved in note issue, political and bureaucratic interests inevitably overwhelm any public-interest motivations on the part of policymakers. Therefore, the best course of action would be to abolish central banks and introduce a system of “free banking.”

Dowd begins his analysis with a discussion of the virtues of competition, invoking the “invisible hand” arguments of Adam Smith. Dowd then argues that money is no different from other commodities, and thus consumers should be allowed to enjoy the benefits of unfettered competition in its supply. Indeed, Dowd puts the burden of proof on supporters of central banking to identify what is different about money that its issuer should be granted monopoly powers.

Next, Dowd describes how a free banking system would operate. The controversy over free banking rests on two concerns: (1) whether there are methods available to prevent the over-issue of bank notes; and (2) whether the banking system can protect itself against destabilizing runs—in short, whether a private lender of last resort would emerge.

In a free banking environment, protection against over-issue of notes is provided either by private citizens or by private clearinghouses. The ability to return notes to the issuing institution for redemption effectively disciplines banks in their note-issuing activity. However, once monopoly power is granted in note-issue and inconvertibility is introduced, this discipline breaks down. Notes in such a world cannot be returned to the (single) issuer. The equilibrating mechanism in the money market is then an increase in the price level. Evidence of these propositions is provided by contrasting the early 19th-century free banking system in Scotland with the monopoly control exercised by the Bank of England. Note issues were relatively stable in Scotland, while over-issues resulted in a series of acute crises during the same time period in England.<sup>1</sup>

The emergence of private clearinghouses addresses the second concern about free banking. In the spirit of Richard Timberlake and Gary Gorton, Dowd describes how in several instances private clearinghouses effectively

<sup>1</sup>See Lawrence H. White, *Free Banking in Britain: Theory, Experience, and Debate, 1800–1845* (Cambridge: Cambridge University Press, 1984) and George A. Selgin, *The Theory of Free Banking: Money Supply under Competitive Note Issue* (Towota, N.J.: Roman and Littlefield, 1988).