

# THE STATE AND THE NETWORKED ECONOMY

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## I. INTRODUCTION

This Essay will examine how the networked economy may affect the cause of liberty. The traditional view, very evident in the novels *1984*<sup>1</sup> and *Brave New World*,<sup>2</sup> has been pessimistic about information technology's probable effect on liberty. My own view is that the new networks, spawned by the Internet and other information technology, are hopeful developments. I will defend this optimistic viewpoint by looking at the history and nature of the state, including the despotic state, and then examine how information technology will predictably alter the balance between liberty and despotism.

## II. PRIOR THEORIES OF THE ORIGIN OF THE STATE

I will examine four provocative theories of the origin of the state and then develop a synthesis from them, hopefully adding something new in this last step. The four theories are the Hobbes-Buchanan contractarian theory,<sup>3</sup> Karl Wittfogel's hydraulic despotism theory,<sup>4</sup> Robert Carneiro's circumscription theory,<sup>5</sup> and Mancur Olson's stationary bandit theory.<sup>6</sup> These theories of the origin of the state do not all make claims about how a state whose origin is so conceived will respect human liberty but are at least suggestive of such claims. Only the

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1. GEORGE ORWELL, *1984* (1949).
2. ALDOUS HUXLEY, *BRAVE NEW WORLD* (1932).
3. See discussion *infra* Part II.A.
4. See discussion *infra* Part II.B.
5. See discussion *infra* Part II.C.
6. See discussion *infra* Part II.D.

Hobbes-Buchanan theory describes a constitution, but the other theories can be significantly improved if we add the potential for a constitution along lines Michael McGuire and I have previously suggested.<sup>7</sup>

#### A. *The Hobbes-Buchanan Contractarian Theory*

Thomas Hobbes famously began his analysis with a consideration of the state of nature. He assumed that before formal governments existed people were reasonably equal in endowments.<sup>8</sup> From this rough equality of mental and physical assets, each had an equal hope of acquiring the same ends, which were scarce. Hence, individuals fell into competition with each other, which resulted in the “war of every man against every man.”<sup>9</sup> In such a state, opportunities for production, investment, learning, and exchange were limited, because each individual possessed “continual fear and danger of violent death.”<sup>10</sup> In order to relieve themselves of eternal conflict, individuals have an incentive to organize themselves into a commonwealth, which is a hierarchy that “tie[s] them by fear of punishment to the performance of their covenants and observation of th[e] laws of nature . . . .”<sup>11</sup> They institute this commonwealth by giving a monarch or an assembly the right to represent them.<sup>12</sup>

Two hallmarks of Hobbes’s analysis are that people at least hypothetically agree to a constitution that (1) legitimizes private law and (2) does not otherwise limit the sovereign’s

7. Mark F. Grady & Michael T. McGuire, *The Nature of Constitutions*, 1 J. BIOECONOMICS 227, 238 (1999) (finding that constitutions are not a product of consensual choice, but rather the result of weaker humans banding together to resist forceful appropriations from more dominant humans).

8. He wrote:

Nature hath made men so equal in the faculties of body and mind as that, though there be found one man sometimes manifestly stronger in body or of quicker mind than another, yet when all is reckoned together the difference between man and man is not so considerable as that one man can thereupon claim to himself any benefit to which another may not pretend as well as he.

THOMAS HOBBS, *LEVIATHAN* 74 (Edwin Curley ed., Hackett Publ’g Co. 1994) (1668).

9. *Id.* at 76. For Hobbes, war did not consist only of actual battles, but also threats of battle. *Id.* (“For War consisteth not in battle only, or the act of fighting, but in a tract of time wherein the will to contend by battle is sufficiently known.”).

10. *Id.*

11. *Id.* at 106.

12. *See id.* at 110.

appropriations from his (or its) subjects. In fact, Hobbes was fairly adamant that the constitution did not limit sovereign appropriations. His analysis constantly emphasized that the constitutional problem was the legitimacy of private law.

Because Hobbes thought that worthy private law rules could not arise in the state of nature, he had to posit a commonwealth, created by the hypothetical contract among subjects or citizens, as the foundation for these rules, which he analyzed in detail. Correspondingly, when it came to the natural limits that might exist for the sovereign's appropriations, Hobbes found few. For instance, he asserted that no subject had the right to defend another against any government imposition, just or unjust, though he did admit the right of any subject to defend at least his own person against violent force, whether wielded by the commonwealth or by another subject.<sup>13</sup> Nevertheless, despite Hobbes, the real constitutional problem is the legitimacy of the sovereign's appropriations, as most constitution framers have recognized.

Even so able an analyst as James Buchanan has followed Hobbes in stressing as a problem the constitutional legitimacy of private law rules. More explicitly than Hobbes, Buchanan has claimed that the problem of sovereign appropriation is inextricably linked to the legitimacy of private law rules. In his justly acclaimed work *The Limits of Liberty*,<sup>14</sup> Buchanan formalized and extended Hobbes's analysis. Buchanan argues that it is useful to conceive of civil society as the result of three

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13. *See id.* at 143. Hobbes's detailed argument on this point is instructive:

To resist the sword of the commonwealth in defence of another man, guilty or innocent, no man hath liberty, because such liberty takes away from the sovereign the means of protecting us, and is therefore destructive of the very essence of government. But in case a great many men together have already resisted the sovereign power unjustly, or committed some capital crime for which every one of them expecteth death, whether have they not the liberty then to join together, and assist, and defend one another? Certainly they have; for they but defend their lives, which the guilty man may as well do as the innocent. There was indeed injustice in the first breach of their duty; their bearing of arms subsequent to it, though it be to maintain what they have done, is no new unjust act. And if it be only to defend their persons, it is not unjust at all. But the offer of pardon taketh from them to whom it is offered the plea of self-defence, and maketh their perseverance in assisting or defending the rest unlawful.

*Id.*

14. JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN* (1975).

steps: (1) a natural distribution of resources; (2) a constitutional contract that is negotiated between the members of society; and (3) a post-constitutional regime in which other contracts between society members become possible because of the constitutional contract.<sup>15</sup> The natural distribution of the resources is simply the one that results from the original, supposed Hobbesian anarchy in the state of nature. The parties' attacks against each other and their defenses yield a distribution of goods between them and de facto private property.<sup>16</sup> This natural distribution then becomes the basis for Buchanan's constitutional contract.<sup>17</sup> The parties realize that they can save their costs of attack and defense against each other if they all agree to a constitution that allocates legal property rights among them and then delegitimizes their further appropriations of each other.<sup>18</sup> Moreover, besides a law of property, the members of society can also agree to a law of contract, which is implied by their agreement to outlaw forcible appropriations of property.<sup>19</sup> In this new world, created by the constitutional contract, the parties save the costs of attack and defense and acquire the benefits of trade.<sup>20</sup>

Buchanan's writing is premised on the notion that the problem of sovereign appropriation logically derives from the problem of knowing how to make the structure of private law legitimate. Nevertheless, as will be discussed in the next section, it is impossible to derive a theory of sovereign restraint from a theory of how private law becomes legitimate. The legitimacy of private law is not a large problem in any event. Even the most extreme despot has an incentive to enforce private law rules that maximize social wealth so that he can appropriate more wealth. Efficient private law rules do not depend on a constitutional contract, as Buchanan claims they do; instead, they depend only on the evolution of a hierarchical structure of society that gives some individuals the power to appropriate wealth from others. This hierarchical structure will normally follow either from a disparity of endowments in the

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15. *See id.* at 31.

16. *See id.* at 23–25.

17. *See id.* at 24.

18. *See id.*

19. *See id.* at 17–25.

20. *See id.* at 24–25.

state of nature or from the differing fortunes of different individuals who possess substantially equivalent endowments.

Buchanan's own theory of sovereign restraint is modest. Most despots could evade its requirements. Buchanan writes that "'the government'" might arbitrarily reassign private rights in a way that "violates the basic terms upon which the social structure operates."<sup>21</sup> In this situation, Buchanan reasons, "there is no requirement that its actions be 'honored' with ethical sanctions."<sup>22</sup> The role that Buchanan envisions for the sovereign is an "enforcing agent for individual rights . . ."<sup>23</sup> Nevertheless, he argues that a sovereign might overstep and alter the system of private rights, which would deprive individuals of their private rights.<sup>24</sup> This is a basic theme that runs through public choice literature, which Buchanan and Gordon Tullock founded.<sup>25</sup> The basic constitutional danger is supposedly the sovereign (or, as Buchanan says, "'the government'") that does evil by altering the structure of private rights.<sup>26</sup> Yet an overreaching sovereign is far less likely to appropriate by altering contract rules or even rules of private property than by simply raising taxes.

A sovereign that appropriates private property for its own use would not violate private property rules as they are conventionally understood. Such a sovereign might violate a

21. *Id.* at 83-84.

22. *Id.*

23. *Id.* at 84; *see also id.* at 67-70 (explaining the necessity for the governmental enforcing agent).

24. Buchanan wrote:

If "the government," which is conceived as an enforcing agent for individual rights, itself captures powers to change the legal structure, individuals are deprived of rights and their existence becomes equivalent to that described in Hobbesian anarchy. Much of what we observe in the 1970s can pessimistically be described in precisely these terms.

*Id.* at 84.

25. *See* JAMES BUCHANAN & GORDON TULLOCK, *THE CALCULUS: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (1962).

26. Buchanan expanded on this theme:

[M]y analysis lends potential support to modern-day anarchists, who deny the legitimacy of much of the action implemented by the governmental-bureaucratic apparatus. Legitimacy is "earned" by government's adherence to the terms of the legal structure that allows individuals' claims to remain within a set of reasonable renegotiation expectations, at least for most members of the community. If government oversteps these bounds, it is not "legitimate" in the strict definitional sense of the term, and its acts may be regarded as "criminal."

BUCHANAN, *supra* note 14, at 84.

public right defined by a real constitution; a Hobbesian constitutional contract does not define in any detailed way restraints on the sovereign power to take private property for sovereign purposes. Private property rules govern behavior by private individuals. To argue that the sovereign is subject to the same rules has no basis in the constitutional contract that Buchanan describes because this is a bargain between private individuals. Nevertheless, a theme that runs through the public choice literature is that we can spot a despotic government by how little it respects and enforces private rights. This is a mistake. A despotic government could fully enforce the most just or efficient private property rights but then tax away a huge fraction of the social surplus yielded by these rights. Even a despotic democratic majority would be unlikely to appropriate through altering private rights; instead, it would take the minority's property for the benefit of the majority.

Most public choice economists and modern libertarians have argued that the problem of despotism arises from ambiguities in private rights.<sup>27</sup> These critics seem to reason from the premises of a legal system that never existed. In real-world legal systems, private rights and obligations exist among private persons; sovereign rights and obligations exist among sovereigns. Moreover, sovereign obligations that run against the purely selfish interest of the sovereign arise only from real constitutions, which are often imposed on the sovereign by threats of violence from subordinates rather than from Hobbesian bargains among subordinates. The subordinates do not have to agree that they do not want to be excessively appropriated. If anything, they need to agree among themselves to resist the sovereign's appropriation (which Hobbes saw as a criminal conspiracy).

As we will see, the new social and political structures facilitated by information technology create the possibility of something very much like a constitutional contract. Hobbes and Buchanan have not fully addressed the problem of sovereign appropriation. At least Hobbes assumed that the sovereign would behave benevolently. Nevertheless, with a

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27. See, e.g., *id.* at 178 ("A necessary step in the process of genuine constitutional revolution is a consensual redefinition of individual rights and claims. Many of the interventions of government have emerged precisely because of ambiguities in the definitions of individual rights.").

monopoly of force over a particular geographic area, a sovereign possesses a private incentive to appropriate from his subjects. The networked economy, by creating a greater mobility of people and assets, reduces the ability of sovereigns to appropriate because their subjects can more easily exit overreaching regimes. Also, the reduction in transaction costs created by the Internet and by information technology more generally creates the possibility of competing Hobbesian commonwealths, each constituted by customers and dependent upon their continuing loyalty.

### *B. Karl Wittfogel's Hydraulic Despotism Theory*

In his 1957 book *Oriental Despotism*,<sup>28</sup> Karl Wittfogel argued that despotic governments often arose around rivers, as in ancient Egypt, China, and Mesopotamia. He theorized that the state arose when villages banded together to develop common irrigation projects, which vastly improved the productivity of agriculture.<sup>29</sup> Nevertheless, once the state came into being as a means of developing irrigation, it soon turned its bureaucracy to oppressive purposes.<sup>30</sup> In fact, according to Wittfogel, a hydraulic state will cease appropriating only when the marginal cost of further administrative control begins to exceed the marginal revenue to those benefiting from state action.<sup>31</sup>

28. KARL A. WITTFOGEL, *ORIENTAL DESPOTISM: A COMPARATIVE STUDY OF TOTAL POWER* (1957).

29. He wrote:

In a landscape characterized by full aridity permanent agriculture becomes possible only if and when coordinated human action transfers a plentiful and accessible water supply from its original location to a potentially fertile soil. When this is done, government-led hydraulic enterprise is identical with the creation of agricultural life. This first and crucial moment may therefore be designated as the "administrative creation point."

*Id.* at 109.

30. *See id.* at 126-36.

31. Wittfogel wrote:

The power of the hydraulic despotism is unchecked ("total"), but it does not operate everywhere. The life of most individuals is far from being completely controlled by the state; and there are many villages and other corporate units that are not totally controlled either.

What keeps despotic power from asserting its authority in spheres of life? Modifying a key formula of classical economics, we may say that the representatives of the hydraulic regime act (or refrain from acting) in response to the law of diminishing administrative returns.

*Id.* at 108-09.

### C. Robert Carneiro's Circumscription Theory

In an influential article, the anthropologist Robert Carneiro theorized that states began in areas of environmental or social circumscription.<sup>32</sup> Carneiro looked at the places where states first arose, areas such as the Nile, Tigris-Euphrates, and Indus valleys in the Old World and the Valley of Mexico and the mountain and coastal valleys of Peru in the New World.<sup>33</sup> He found that all were areas of "circumscribed agricultural land."<sup>34</sup> In his words, "[e]ach of them is set off by mountains, seas, or deserts, and these environmental features sharply delimit the area that simple farming peoples could occupy and cultivate."<sup>35</sup> He contrasted these "environmentally circumscribed" areas to areas in which states did not arise as early, for instance, the Amazon basin and the eastern woodlands of North America.<sup>36</sup>

According to Carneiro, the significance of circumscription came from warfare. In a circumscribed area, warfare would tend to unify the people under one government—the government of the ultimate victor in what could be a long process.<sup>37</sup> In an uncircumscribed area, losing groups or clans could simply flee a dominant military power and thereby avoid becoming part of a state.<sup>38</sup> Carneiro gives many examples of the key roles played by warfare in the rise of the state.<sup>39</sup>

Carneiro then extended his theory by arguing that in a sufficiently populated area, social circumscription could replace environmental circumscription.<sup>40</sup> Indeed, he attributes this idea to Napoleon Chagnon, the great ethnographer of the Yanomamö Indians of Venezuela.<sup>41</sup> The Yanomamö live in

32. See Robert L. Carneiro, *A Theory of the Origin of the State*, 169 *SCIENCE* 733, 738 (1970).

33. See *id.* at 734.

34. *Id.*

35. *Id.* at 734-35.

36. *Id.* at 735.

37. See *id.* at 736.

38. See *id.* at 735.

39. Carneiro wrote: "Historical or archaeological evidence of war is found in the early stages of state formation in Mesopotamia, Egypt, India, China, Japan, Greece, Rome, northern Europe, central Africa, Polynesia, middle America, Peru, and Colombia, to name only the most prominent examples." *Id.* at 734.

40. See *id.* at 737.

41. See *id.* (citing N. A. Chagnon, *Proceedings, VIIIth International Congress of Anthropological and Ethnological Sciences*, 3 *ETHNOLOGY AND ARCHAEOLOGY* 249, 251 (1968)).

many local villages, each more or less autonomous, distributed across vast ranges of physically uncircumscribed rain forest.<sup>42</sup> When villages become large, they tend to divide for two reasons: (1) intravillage frictions become more difficult to manage as the village becomes more populous and (2) resources become scarcer to village members as the number of people in one place increases. Nevertheless, in the distribution of the villages, village size tends to be larger and wars more numerous near the central core, where villages are closer together and it is more difficult for villages to escape attack by moving.<sup>43</sup> Having more village members is useful both for attacking neighboring villages and defending against attacks. Thus, in the central core, villagers are more willing to pay a price (in terms of more internal fights and resource scarcity) in order to have more external security. Chagnon and Carneiro both call this tendency "social circumscription."<sup>44</sup> Nevertheless, it is similar to physical circumscription because it, too, depends on the scarcity of good land.<sup>45</sup>

If the existence of potentially oppressive states depends on geographic scarcity, whether the ultimate source is physical or social resources, the networked economy should be a place of liberty. By reducing geographic scarcity, networked economies could eliminate circumscription either in its environmental or social guise.

#### *D. Mancur Olson's Stationary Bandit Theory*

Mancur Olson has argued that the state can be likened to a stationary bandit who robs the people within his jurisdiction (through taxes and the like) and protects them from roving bandits.<sup>46</sup> Olson argues that ruled people prefer a stationary bandit to roving bandits because the stationary bandit has an incentive to invest in public goods that increase the people's wealth and therefore the tax revenues that can be extracted from them.<sup>47</sup> This theory is very similar to a more general

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42. *See id.*

43. *See id.*

44. *Id.*

45. *See id.*

46. *See* Mancur Olson, *Dictatorship, Democracy, and Development*, 87 AM. POL. SCI. REV. 567, 568-70 (1993).

47. *See id.* at 569.

theory developed independently by Michael McGuire and me to explain primate, including human, political structures.<sup>48</sup> The basic idea common to both our theory and Olson's is that the sovereign is effectively the residual claimant of the group he or she rules. When the group creates a surplus, the sovereign is in a position to appropriate that surplus. Olson stressed that the sovereign's position of residual claimant could induce the sovereign to create public goods, such as irrigation projects (to use Wittfogel's example); then, the sovereign could appropriate the surplus from these investments.<sup>49</sup> We stressed that the sovereign would have a self-interested incentive to keep peace within the group and even to enforce efficient private law because these kinds of legal rules would increase the surplus from group activities and therefore create a greater possibility for sovereign appropriations.<sup>50</sup>

### III. A POSITIVE THEORY OF LIBERTY

In this section, I will outline a new theory of liberty that will, among other things, assist us in seeing how the networked economy may affect human freedom.

Let us suppose that the sovereign (king, ruling caste, band of aristocrats, democratic majority, etc.) is a self-interested maximizer. Such an individual or group would wish to appropriate from other less powerful individuals, whom we can call "subordinates." Sovereign appropriations could take a variety of forms: seizing the subordinates' property, conscripting their labor, taxing them, and so forth. In return, the sovereign may provide—almost certainly will provide—the subordinates with various public goods, such as peacekeeping services, other mediation and judicial services, public works, national defense, and so forth. Although it is possible that the sovereign will take from his subordinates only an amount that covers the cost of what he gives back to them, plus a reasonable return for his own labor, history is full of examples in which the sovereign takes more and sometimes quite a bit more. This excessive amount can be called a "sovereign rent."

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48. See Mark F. Grady & Michael T. McGuire, *A Theory of the Origin of Natural Law*, 8 J. CONTEMP. LEGAL ISSUES 87 (1997).

49. See Olson, *supra* note 46, at 569-71.

50. See Grady & McGuire, *supra* note 48, at 118-20.

Subordinates, who are also self-interested maximizers, have an incentive to resist sovereign rents. They have three basic strategies: exit from the sovereign's jurisdiction, resistance, and revolution. Each of these strategies has costs. When subordinates exit the jurisdiction, they lose not only the public goods that the sovereign has provided but also the natural advantages of the land and group of people that they are leaving. They can also lose immovable investments in their old land and former group. Resistance and revolution also entail costs, often to life and limb, as my colleague Gordon Tullock has stressed.<sup>51</sup> An especially important form of resistance is a constitution, which can be either formal or informal. The simplest type of constitution is an agreement among subordinates that they will treat an excessive appropriation against one as an attack against all.<sup>52</sup> A more advanced constitution, such as the U.S. Constitution, explicitly limits sovereign appropriations and marshals the state's power in support of these sovereign limitations.<sup>53</sup>

In this theory, liberty depends on the interaction of the government's ability to appropriate and citizens' ability to resist appropriation. A first approximation of a person's liberty is the proportion of a person's opportunity set left to that person by the state. People enslaved by the state or very highly taxed have little liberty. Other aspects of liberty could be largely derivative. For instance, freedom of speech enhances someone's opportunity set but, perhaps more critically, allows that individual to organize with others to resist excessive government appropriation.

#### IV. THE POSITIVE THEORY PREDICTS DESPOTISM

This positive theory predicts despotism in many early civilizations, especially those first identified by Karl Wittfogel as examples of Oriental despotism.<sup>54</sup> State appropriations can

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51. See Gordon Tullock, *Autocracy*, in *ECONOMIC IMPERIALISM: THE ECONOMIC APPROACH APPLIED OUTSIDE THE FIELD OF ECONOMICS* 365, 374-75 (Gerard Radnitzky & Peter Bernholz eds., 1987).

52. See Grady & McGuire, *supra* note 7, for a more detailed analysis of this subject.

53. See U.S. CONST. amend. V ("No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.").

54. See WITTFOGEL, *supra* note 28 (identifying ancient civilizations such as

be largest when the society is located next to some scarce and highly productive natural resource, such as the Nile River. Given the Nile's enhancement of a particular farmer's wealth, the state can take a large portion of that person's income before that person would be better off moving away from the Nile, especially if the river's agricultural area is a relatively thin strip surrounded by desert. In effect, the sovereign can convert the productivity of the river into tax revenues (or enslavement and other limitations on liberty). Under the same reasoning, early Mesopotamian civilizations were highly predisposed to despotic governments. Conversely, a country like England would be less disposed to despotism; it possesses dispersed agricultural land and gathering patches watered by rain, as opposed to rivers, as well as plentiful and dispersed wild game. If a despot tried to appropriate large sovereign rents, his subordinates would simply move to a different area. Thus, dispersed natural resources allow easy exit and set up a competition among rulers for subjects.

Wittfogel thought that rivers spawn complex administrative systems as the sovereign seeks to build and to manage irrigation systems, and that in some subsequent period the sovereign adapts these administrative systems to oppression.<sup>55</sup> The actual logic is more simple than Wittfogel theorized: rivers increase production and when exit possibilities are poor, tax rates can be high. A despot has an incentive to develop an irrigation system from a river if it will increase the productivity of the land because he can then tax away the increment without inducing exit. For the despot, a public good can be a private investment—a point that Mancur Olson has stressed.<sup>56</sup> In Carneiro's terms, the irrigation system would increase circumscription, though this seems an awkward way of putting it. From a functional point of view, Carneiro's concept of circumscription approximates unusually good natural resources and poor exit possibilities.

Hobbes and Buchanan have argued that subordinates must organize, at least hypothetically, a social contract in order to

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Egypt, China, and Mesopotamia as despotic governments due to their need for extensive irrigation systems).

55. See *supra* notes 29-31 and accompanying text.

56. See Olson, *supra* note 46, at 569-71.

constitute private law, such as tort, contract, and property.<sup>57</sup> Although a social contract is plausible in some societies—possibly hunter-gatherer societies or cities or even in democracies following a revolution—private law can also arise in the presence of despotism. If a despotic sovereign enforces private contracts among his subjects, he increases social wealth and thus his tax base. In fact, enforcing contracts, punishing torts, and enforcing private property rights between his disputing subordinates are all sovereign acts analogous to building a public irrigation system. Each sovereign investment increases the tax base.

Martin McGuire and Mancur Olson have argued that the main difference between despotism and democracy lies in their different perspectives on appropriation.<sup>58</sup> Because the autocrat is just one individual, he collects taxes and does not pay them. In a democracy, all pay taxes. Hence, a democratic majority is more concerned about the distorting effects of taxes than is an autocrat and therefore moderates its tax demands. Again, this theory seems too complicated. The basic feature of non-despotic regimes, whether democracy or otherwise, is the ability of subordinates (citizens, subjects) to limit sovereign appropriations. In a small group, it is relatively easy for subjects to solve the collective-action problem entailed by an agreement to resist excessive sovereign appropriations. Hence we would not predict despotism in small groups of humans, however close they might live to a river or other source of circumscription. Early democracies are hunter-gatherer groups, which tend to be highly egalitarian.<sup>59</sup> Large-scale societies, in which informal constitutions are difficult to enforce, are more disposed to despotism than small bands of individuals who can more easily unite.

## V. HOW THE NETWORKED ECONOMY CAN INCREASE LIBERTY

The new globally networked economy seems likely to

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57. See *supra* Part II.A.

58. See Martin C. McGuire & Mancur Olson, Jr., *The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force*, 34 J. ECON. LIT. 72, 73 (1996). This argument continues a theme first developed in Olson, *supra* note 46.

59. See CHRISTOPHER BOEHM, HIERARCHY IN THE FOREST: THE EVOLUTION OF EGALITARIAN BEHAVIOR 64-65 (1999).

increase liberty. Perhaps most importantly, it vastly expands opportunities for exit from the sway of local monopoly, whether sovereign or private.

In addition, the global economy is already spawning structures that are much more libertarian than traditional governments. A traditional government produces public goods and taxes people to support both those public goods and a sovereign rent. Consider a hub website such as Cordiem.com<sup>60</sup> or Covisint.com.<sup>61</sup> These organizations also produce public goods such as contract enforcement, which it accomplishes by evicting people who do not obey the rules. Competition among these organizations, created by the ability to exit one and sign up with another, could drive sovereign rents to zero. Additionally, governments, which are in the same law enforcement business, may have to reduce their sovereign rents in response.

These new "commonwealths" operate on a radically different economic principle than traditional geographic empires or nation-states. In the geographic nation-state, subjects' specialization in each other (a common language and common culture) exists in a geographic frame in which the sovereign can control their activities and appropriate their surpluses. In effect, the subjects become specialized to the land that the sovereign controls. They also make physical investments in the land that the sovereign can also appropriate. The sovereign's own public goods, including its legal system, is also limited to this geographical space, which invites subjects to specialize in it, for instance, by becoming experts in the sovereign's law. These investments can also be appropriated.

In the networked economy, communities will be less tied to geography and to physical assets. Sovereigns may thus compete with each other. Sovereigns could not costlessly appropriate all benefits from being a part of the community but would instead have to limit their appropriations based on offers made by other sovereigns. Moreover, the surplus

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60. See Cordiem, *About Us*, at <http://www.cordiem.com/aboutus/home.cfm> (last visited Dec. 20, 2001) (advertising "end-to-end e-business solutions" for the aviation industry).

61. See Covisint, *About Covisint*, at <http://www.covisint.com/about> (last visited Dec. 20, 2001) (advertising Covisint as a "central hub" for conducting business in the automotive supply industry).

retained by individuals from their community interactions becomes a stake that will allow the community manager to enforce rules. Ostracism from the community imposes a cost, and this cost can be helpful in assuring behavior that complies with the community's rules.

## VI. CONCLUSION

Despotism critically depends on controlling geographical space and specialized investments that are made within this space. As the networked economy makes humans and their investments more mobile, liberty should increase. Moreover, new structures, such as communities organized around a website, should further increase liberty by making it possible for individuals to change communities more or less costlessly without losing their investments. These reduced exit costs should reduce sovereign appropriations.

