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A Guide to Research and Study

Inside HSR:

- Does the existence of public goods justify government intervention in the operations of the market? Dan Garrett addresses this question as he reviews the important new book by David Schmidtz, *The Limits of Government: An Essay on the Public Goods Argument*.

- Do "commerce" and "art" delineate two separate and incommensurable spheres of activity? Donald McCloskey takes a provocative look at the relationship between economics and literature.

- Voluntary "fraternal" organizations once provided medical care, death benefits, and much more to millions of working Americans. These organizations have all but disappeared. Leslie Siddeley introduces the history, the economics, and the documentary evidence for the fraternal movement, and outlines a research agenda to explain their decline.

BOOK REVIEW

Public Goods and the Justification for the State

by Dan Garrett

A review of David Schmidtz's *The Limits of Government: An Essay on the Public Goods Argument* (Boulder: Westview Press, 1991)

Is state power legitimate? Modern political theorists typically legitimize the state with two major ideas: redistribution and the provision of public goods. In *The Limits of Government*, David Schmidtz takes on the second of these ideas, the public goods justification for the state. He gives this argument a workover and reaches some surprising conclusions.

The public goods justification for the state, so impressive to economists and political scientists, goes roughly like this. While a market system may allow self-interested individuals to create and allocate many goods optimally, there exists a class of goods—collective or public goods—that are not produced adequately in a market system. These collective goods are goods that all individuals want but for whose production it is often not *individually* rational for people voluntarily to do their part to secure a *collectively* rational outcome. The state can step in and force us all to contribute toward the production of these goods, and we can all thereby be made better off.

There are other arguments for the legitimacy of the state, but Schmidtz focuses exclusively on this particular argument. He points out that this argument is paternalistic in character, as are most arguments for the state. But the public goods argument is special in that it requires a particularly benign kind of paternalism.

> This paternalism is benign in the sense that the end it helps us attain is not only good for us but is also an end we actually desire. We all *want* the government to force each of us to contribute and thereby make us better off. Even if no one desires that the government take his or her money, it might nevertheless be true that everyone desires that the government take everyone's money. (p.2)

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CURRENT ISSUES IN LITERATURE

Reading the Economy

by Donald McCloskey

I have been thinking about an anthology of literature on the economy, a garland for those, as Hopkins said, "seared with trade; bleared, smeared with toil." It would collect the best writing about the economy, about toiling and trading, from the literary side. It would contain Homer and Shakespeare, not Adam Smith and J.M. Keynes (saved for another day). Its implied readers would be people who toil and trade or people who watch them—most of us, in short. We need to be un-seared, bleared, smeared.

On the first page of *The Principles of Economics* (New York: MacMillan Press, 1961, 9th Ed.), Alfred Marshall defined the subject as "a study of mankind in the ordinary business of life."

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Public Goods (Continued from page 1)

The benign nature of the normative premise behind the public goods argument explains why political theorists and particularly economists accept the argument so readily. The argument accords perfectly with economists' near-universally accepted yardstick—the Pareto principle—that actions or institutions that make everyone better off are efficient and in some strong sense good. It is, at least on its face, as uncontroversial as normative premises get.

Having sketched an explanation for the popularity of the public goods argument, we now ask whether that popularity is justified.

Justifications For the State: Teleological Vs. Emergent

Schmidtz begins consideration of the public goods argument by first categorizing in a general way moral justifications for the state. He wants to understand what *kind* of justification the public goods argument is in order to see what kind of criticisms are possible. Schmidtz argues that there are two different methods of justification in political philosophy.

> I call the two methods *teleological* and *emergent* justification. The teleological approach seeks to justify institutions in terms of what they accomplish. The emergent approach regards justification as a property that emerges from the process by which institutions arise. (p.3)

In debates, we must be aware of the difference between these justifications to avoid needless confusion; one person may be offering a teleological justification of a particular institution and another may be offering an emergent criticism. Their conclusions might "pass each other like ships in the night."(p.7) Supplying both justifications should satisfy almost everyone, but there seems to be no court to handle disputes that arise from a disagreement between the conclusions from each justification. Schmidtz's discussion of this taxonomy is straightforward and, for me, helpful.

Schmidtz goes on to argue that a major class of justifications—hypothetical consent justifications—are irrelevant to institutional justifications generally. Emergent justifications must rest on actual historical events, and so a *hypothetically* consensual emergence is irrelevant. And using a hypothetical consent story as a teleological justification simply obfuscates; the power of the argument rests on the justification of the end-state and not on the hypothetical process that got there. Commentators on Rawls have made this point already; I believe Schmidtz does it more succinctly and more generally.

A Detour: Justification of Property Rights

In Chapter 2, entitled "Property," Schmidtz points out that the Lockean justification for private property is an emergent one. The difficulty most philosophers have with justifications for property rights concerns original appropriation, or the first removal of the property from the state of nature. Locke said that original appropriation by an individual was legitimate as long as enough and as good were left in common for the rest of society. This so-called "Lockean Proviso," when taken at face value, seems to make little or no appropriation justifiable. And, since the legitimacy of property claims rests for Locke on an emergent justification, illegitimate original appropriation implies illegitimate ownership thereafter.

Schmidtz comes to a different conclusion, by drawing insights from the "tragedy of the commons." If no one appropriates the property, society will overuse and ultimately destroy the commonly owned property. Since the Lockean Proviso was intended to assure that people could always have the use of some property, the fact that common ownership leads to no one's ability to use the property means that common ownership itself violates the Lockean Proviso. "Leaving goods in the commons fails to satisfy the Proviso." (p.21) Schmidtz makes another point: "It is not that appropriation of land inevitably decreases the amount of land available to others. It only inevitably decreases what is available for *original appropriation* by others, which is not the same thing at all." (p.27) Thus, rather than severely limiting the extent of justified original appropriation, the Lockean Proviso, as Schmidtz interprets it, justifies widespread original appropriation of resources.

Public Goods Problem as Prisoner's Dilemma

In Chapter 4, "The Prisoner's Dilemma," Schmidtz returns to the public goods argument. He sets up the public goods problem as a prisoner's dilemma. There are two reasons force may be necessary to produce an optimal quantity of a collective good. First, if asked to contribute voluntarily, an individual may realize that the others in the community are contributing enough to produce the good and decide to enjoy the good for free. Using the normal economics nomenclature, Schmidtz calls this the "free rider" problem. Second, an individual might not contribute because she thinks the project will be underfunded anyway. She lacks the assurance that other people will contribute, and so she fails to contribute to avoid wasting money. This Schmidtz calls the assurance problem. These two problems are conceptually separable. It is with Schmidtz's deft handling of the assurance problem that he begins to develop his strong case.

Schmidtz considers a hypothetical attempt to fund an AIDS research project. He suggests an assurance contract, a money back guarantee of sorts that states something like,

> The contract is enforceable against a contractor if and only if the rest of the group agrees to contribute enough to ensure that the project's total funding is sufficient to produce a return *R* that exceeds the contractor's cost *c*. (p.66)

This contract gets around the assurance problem; every would-be contributor can be assured that their pledge will only be taken if enough pledges come in to guarantee the project's viability. There would still be the free rider problem, however.[1]

Here Schmidtz inserts three possible reasons why any particular alleged free-rider problem may *not* be a problem. 1) People may enjoy participating in the venture. 2) If exclusion of some benefits is possible, it could be that it is worthwhile to contribute to gain the benefits that would have been lacking. For example, if getting the AIDS vaccine were tied to contributing to the research project, then it might be a best response to contribute.[2] 3) Finally, there is the option of a unanimous commit-

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BIBLIOGRAPHIC ESSAY

The Rise and Fall of Fraternal Insurance Organizations

by Leslie Siddeley

The Ancient Order of United Workmen, The Independent Order of Oddfellows, The Knights of Pythias. For most people under forty, these names trigger images of rotund middle-aged conventioneers with funny hats exchanging secret handshakes. Very few young people take these organizations seriously, and even fewer would consider joining one. But in fact, fraternal organizations like these were once the center of a vast private mutual aid network, providing social insurance for Americans of every race, ethnicity, and income group.

The fraternal insurance movement in America began in 1868. At this time, the insurance industry in America was young, and life insurance was a luxury reserved for the rich. This began to change, however, when a group of railroad mechanics from Readville, Pennsylvania formed a fraternal organization which had among its functions the provision of life insurance for its members.

The idea caught on, and by 1920 the National Fraternal Congress, an association of fraternal societies, boasted 200 member societies with 120,000 local affiliated lodges. These 200 societies insured nine million members with over $9,500,000,000 of life insurance in force.

The member societies of the NFC were just the tip of the iceberg. For example, we know that in 1918 there were 313 non-NFC fraternal organizations providing insurance to the immigrant poor in Chicago alone. In fact, fraternal insurance was by far the most popular type of insurance among the immigrant poor, as well as among native blacks. Despite their poverty, these groups had levels of insurance equal to, and sometimes greater than, native whites.

Fraternal organizations did not limit themselves to life insurance. Many provided protection against loss of income from sickness or accident. Some even provided medical care through "society doctors" on a fixed fee basis, much like today's HMOs. Also, many fraternals extended aid to their members even when there was no claim under the benefit rules, thus combining charity with mutual aid.

The fraternals appear to have peaked around 1920, but declined slowly until after the Second World War, and then began to decline precipitously. The story of their rise and fall is largely untold, presenting many opportunities for research and publication in a number of disciplines including history, economics, political science, and sociology.

General Historical Account

The American fraternal tradition had its roots in the British friendly societies. The friendly societies, in turn, were extensions of the medieval guilds, and ultimately of the burial societies of antiquity. For an excellent account of the evolution of the idea of mutual aid through the late middle ages, see Anthony Black's *Guilds and Civil Society* (Ithaca: Cornell University Press, 1984). There are also numerous histories of British friendly societies, including *Self-Help: Voluntary Associations in the 19th Century* (London: B.T. Basford Ltd., 1973) and *The Friendly Societies in England 1815-1875* (New York: Augustus M. Kelly Publishers, 1967), both by P.H.J.H. Gosden.

In contrast, there are only two general accounts of American fraternal insurance. Walter Basye's *History and Operation of Fraternal Insurance* (Rochester: The Fraternal Monitor, 1919) provides a thorough history of the rise of fraternalism in America, as well as detailed information about the operation and regulation of their insurance function. However, because it was written at the height of the fraternals' power, it obviously does not chronicle their decline. A recent exploration is "Mutual Aid for Social Welfare: The Case of American Fraternal Societies," by David Beito (*Critical Review*, Vol. 4, No. 4 [Fall 1990]).

Although there is little written about the history of American fraternals in general, there are numerous histories of individual fraternal orders. There are also several assessments of the importance of fraternal insurance to certain communities embedded in general sociological surveys of those communities. Just a few examples include *Homestead: The Households of A Mill Town* (New York: Charities Publication Committee, 1910), in which Margaret Byington devotes a chapter to mutual aid among Slovak employees of the Carnegie Steel Company. There are other accounts of fraternal insurance among members of certain racial and ethnic groups, such as *Mutual Aid for Survival: The Case of the Mexican American* (Malabar, Florida: Robert E. Krieger Publishing Company, 1983) by Jose Amaro Hernandez. William Muraskin traces the history of black freemasonry in *Middle-class Blacks in A White Society: Prince Hall Freemasonry in America* (Berkeley: University of California Press, 1975). David Emmons has studied fraternals among Irish miners in *The Butte Irish* (Urbana: University of Illinois Press, 1989), and Lizabeth Cohen has researched fraternals among industrial workers in *Making a New Deal: Industrial Workers in Chicago, 1919-1939* (New York: Cambridge University Press, 1990).

The good news for researchers with a quantitative approach is that fraternal insurance peaked during the progressive era, when the government was intensively gathering data on a variety of social issues. Toward this end, the government often performed budget surveys that tell us, among other things, how much insurance a subject bought and from whom. This makes possible numerous important studies using data gathered by state insurance commissions and bureaus of labor statistics.

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ment clause. The project gets done if and only if everyone contributes. *Since everyone is assumed to value the project more than they are asked to contribute*, the dominant strategy for everyone is to contribute.

It is at the beginning of Chapter 5, "From Prisoner's Dilemma to Public Goods," that Schmidtz starts turning the knife.

> According to this argument, the state is coercing people for their own good—and they know it. Moreover, they want the state to do this, because they cannot get what they want with voluntary provision mechanisms. Thus, one of the most attractive features of the public goods argument is the minimal nature of the normative assumptions it must make in order to ground a justification of the state. The public goods argument seems to presume only the legitimacy of helping people to do what they want to do but cannot do without the state's help. Yet this picture of the normative side of the coin, so readily accepted by political theorists, turns on an assumption that coercive public goods provision really does make us all better off. (p.82)

However, Schmidtz's result from the previous chapter showed that, under the assumptions of the public goods argument, private provision is possible. Therefore, this version of the public goods argument which rests on such a benign paternalism fails.

If we acknowledge that people differ in their like or dislike for almost everything, then we have to realize that some of the people who don't contribute in a voluntary scheme are honest holdouts. Governmental provision, while it may avoid the problem of free riders, forces honest holdouts to pay for something they do not want. Thus, the normative side of the public goods argument must justify forcing some people to pay for other people's projects. This normative task is far more ambitious than a simple reading of the public goods argument would suggest is necessary. "Merely pointing out that coercing these people is the most efficient way for others to get what they want does not even begin to discharge the burden of proof." (p.84) Schmidtz concludes this section,

Governmental provision, while it may avoid the problem of free riders, forces honest holdouts to pay for something they do not want. Thus, the normative side of the public goods argument must justify forcing some people to pay for other people's projects.

> (1) If we know there are no honest holdouts, we do not need coercion. We can simply require unanimity as a precondition of the contract's validity. (2) If there are honest holdouts but we can tell them apart from others, we do not need coercion. We can require unanimity among those who are not honest holdouts. (3) If we believe there are honest holdouts but cannot identify them, then we may need coercion, but in that case justifying coercion requires us to justify using some as means to the ends of others. (pp.86-7)

Comments And Objections

I will offer three comments on or objections to Schmidtz's arguments in Chapters 4 and 5. First, his conclusion that contributing is a dominant strategy given the assurance contract and the unanimity clause rests on a very specific method of seeking voluntary funding. Namely, the entrepreneur(s) getting people's signatures on the contribution contract must be committed to making either A) only a single try to get funding, or B) multiple tries at unanimous funding. In the case of B, however, a problem arises if the entrepreneur allows for the possibility of excluding early holdouts from the effort in subsequent tries. That is, suppose the entrepreneur, in passes subsequent to the first, revises the contract so that the honest holdouts (m) are deducted from the total number of persons (n) to give the number needed for unanimity. The problem is that this n-m contract provides the opportunity for a potential free rider to pretend she is an honest holdout in order to free ride in a subsequent attempt to fund the project. Even if she really values the project more than her contribution, she might refuse to contribute in the hope that a second contract will be drawn up that is not conditioned on her participation. This would not be a problem if she can be sure that the public goods supplier can make only one pass at the community. If the public goods supplier can make a second pass with a contract that does not include a contribution from her, it might be in her interests to say no the first time.

Schmidtz does discuss this issue in the context of the supplier's going ahead with the project even if there is one holdout. Since the contract states that the supplier must have 100% participation to do the project, he is contractually forbidden from doing the project anyway. I'm concerned with the lack of commitment to take only one pass at the community. If multiple passes are allowed, Schmidtz's payoff matrix does not fully describe the strategies available in a repeated game. (Note that iteration usually makes the likely outcome better than it would be where there was no iteration. See Robert Axelrod's *The Evolution of Cooperation* [New York: Basic Books, 1984] for an extended argument along those lines. Nevertheless, in Schmidtz's scenario, the possibility of repetition makes the optimal outcome less likely.)

This objection—that the possibility of making a second non-unanimous try to get the project funded spoils Schmidtz's equilibrium outcome—can be overcome certainly in some cases and perhaps generally. Commitment mechanisms might be imagined that would limit the potential supplier to making a single "take it or leave it" offer. Furthermore, the time cost of delay to our potential free rider and/or social pressures directed against her might make contributing a best strategy for her. There are no doubt other ways to solve this problem, but I think it is still an objection worth considering.

My second objection relates to the discussion between reviewer Robert Sugden and author Anthony de Jasay (*Social Contract, Free Ride*, [New York: Oxford University Press, 1989]) in the Winter 1991-92 *Humane Studies Review* (Vol. 7, No. 1). Jasay claims that public goods are "indivisible," while Sugden takes many of them to be divisible. (I prefer the terms "lumpy" and "continuous," respectively.) I take Jasay to mean that, in general, supplying a particular public good means supplying a fixed quantity of something, like a "four-lane bridge" or a "100-foot lighthouse." Less than that is insufficient, and more is unnecessary. Sugden is concerned with a public good for which each person's utility is a continuous and increasing function of the quantity and/or quality of the good supplied. (Perhaps "public parks" qualify.) I'll allow that there are both types of public goods, continuous and lumpy. Do continuous goods make any special problems for Schmidtz?

If we have perfect knowledge of people's demands, then state provision might lower transaction costs and might yield the optimal quantity if the good is divisible. But is this a realistic premise on which to base a criticism of voluntary provision?

I think that the production of a specific quantity of either continuous or lumpy goods poses no problem for Schmidtz's mechanism. The production of some given quantity of a public good is, after all, what Schmidtz's mechanism seeks to do. This seems to pose no problem for lumpy goods, which are always available only in discrete "lumps". The reason that production of a continuous good is more problematic, however, is that with its production someone must know and/or decide *how much* of the good is to be produced. For example, a discrete "Welcome to Spoonerville" sign on the main road into Spoonerville (a lumpy good) has a fairly clear optimal quantity connected with it, either 1 or 0. How much open access park space Spoonerville should have is more subtle. Schmidtz does not address the optimal quantity issue[3]; we must ask whether this harms his argument.

The public goods argument is that the state must step in to produce a unanimously desired public good that would otherwise not be produced or would be underproduced through voluntary action. There is no mention of how the state discovers or knows the (presumably) optimal quantity to produce. (To decide how much, say, park space is optimal is no trivial matter in the real world, although it is easy enough when you are given the utility functions in a textbook exercise.) But whatever that optimal quantity is or is believed to be, Schmidtz's mechanism can produce it. So I do not think this concern weakens Schmidtz's argument, although it relates to our conclusions below. For the time being, let's recognize that Schmidtz has *not* given us a mechanism to reveal *degrees* of demand, perfect knowledge of which would allow optimal investment in a divisible public good. An assurance contract with unanimity clauses is not a perfect demand revelation scheme; it only answers whether people prefer contributing some dollar figure *c* over not contributing given that the good won't be produced if they fail to contribute *c*.

My third objection comes from what I believe many economists would say when presented with the result that an assurance contract with a unanimity clause allows voluntary provision of a public good. They would say, "Fine. But the government can produce the same thing and eliminate all the costs of contracting." Governmental provision, they would say, lowers transactions costs. I believe Schmidtz might respond to this by saying that he has shown that the public goods argument is not sufficient to justify the state. If one added the premise that the government can produce a particular collective good at a lower transaction cost than can voluntary means (and if the unanimity condition is met), then that would seem to justify (teleologically) state provision of that good. A teleological justification for the *institution* of the state would require more descriptive premises, including ones that would preclude the state from going beyond its narrow public goods mandate.

So if the claim that governmental provision of some public good(s) involves lower transaction costs than voluntary provision is true then governmental provision would indeed be teleologically justified. (Schmidtz has shown that *without* such a claim the public goods argument for the state fails.) I think Schmidtz would have to admit that such a claim, were it true, would provide grounds for a teleological justification of the state, although he does not discuss it. And so we must ask: Is it true that governmental provision is less costly than voluntary provision?

Economists do a lot of hand waving on this question. A system that allows a government to produce public goods is costly. Resources are spent on voting (demand revelation schemes are costly!), seeking office, lobbying for the policy change, collecting taxes, and so forth. Furthermore, if a referendum on a public goods issue fails a unanimity test, we lose all confidence that the public good in question is unanimously desired, and so we certainly have to go back and justify a more demanding moral premise for the public goods argument. If we use representatives to decide such issues, we not only lose confidence about unanimity but also open the door to rent-seeking activities. That is, people will lobby, under the auspices of public goods, for private goods that benefit them alone but for which others must pay. A major cost, then, of a governmental provision of public goods is that the government will expand into activities well beyond those allowed it by its public goods mandate. These governmental transactions costs must be weighed against the voluntary transactions costs of writing up an assurance contract and collecting signatures. It is not clear to me that collecting signatures is any more costly than a referendum; if cost-effective, an entrepreneur could set up signing booths analogous to voting booths to get the vast bulk of the necessary signatures. And there are far fewer possible negative spin-offs

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with voluntary provision. But this empirical question requires an empirical answer, a research task we voluntarists must take on.

Source of the Disagreement

In an important way the divisible goods issue and the transaction costs issue exemplify the critical premises underlying the disagreements between those who favor voluntary provision of collective goods and those favoring state provision. Those premises concern *what is assumed to be known* about people's demands for goods. If we have perfect knowledge of people's demands, then state provision *might* lower transaction costs and *might* yield the optimal quantity if the good is divisible. But is this a realistic premise on which to base a criticism of voluntary provision? No. The truth is that we don't know what quantities of which collective goods people really want. Let us consider how Schmidtz's mechanism handles some important informational issues relating to public goods.

Schmidtz has put voluntary provision on the same size horse as sits the public goods argument and found that the joust is a draw. My claim is that...voluntary provision wins the match.

The first issue is determining that everyone (or nearly everyone[4]) desires the good in question. The public goods argument rests on the assertion of unanimity, but policy must rest on fact. How could we know whether everyone (or nearly everyone) wants a good? Schmidtz's mechanism certainly gives us that, as witnessed by the signatures. Aside from referenda that clearly link potential cost to benefit, voting mechanisms do not give us a clear picture of the demands of individuals.

The second issue is determining that such and such a way is the best way to provide benefits people desire. How do we know, for instance, whether it is better to spray a large area with pesticide against mosquitos or just wear mosquito repellant? This is in part a question of whether access to the good should be limited or open.[5] Fortunately, Schmidtz has implicitly given us a way to find out which goods are *really* public goods. That is, if a project can succeed using the assurance contract with unanimity, then by god it's a public good. The project is satisfying a demand people have and doing so in a way such that they know no better way. With governmental provision, on the other hand, we have no such assurance. The fact that the government supplies some benefit at zero marginal cost often precludes people from seeking lower cost ways to provide the same benefit, as they have to keep paying for what the government is doing anyway.[6] And importantly, not much of what the government does can be thought of as providing public goods. Most of it is simply wealth transfers, either in the context of actual private goods or of restrictions on trade to benefit a particular class of producers.[7]

The third issue gets back to optimal production of a public good, which we discussed above as a possible area of objection to voluntary provision. With governmental provision, we have no confidence that what we get is an optimal level. For example, do we have an optimal level of national defense? In theory the optimality issue is decided by adding up people's marginal benefit of an additional unit of defense (whatever a "unit" of defense means) and producing defense to the point where the marginal social benefit equals the marginal cost. I may have missed it, but I do not remember Congress going through this calculation or anything like it. In fact, the voting models political economists use to explain Congressional behavior suggest that the optimal outcome would not in general be reached. (For a good discussion of how the government hides costs and magnifies benefits through "fiscal illusion," see James Buchanan's "'La Scienza Delle Finanze': The Italian Tradition in Fiscal Theory," in *Fiscal Theory and Political Economy* [Chapel Hill: University of North Carolina Press, 1960, pp. 24-74].)

Of course, suggesting that one government does not produce an optimal amount of a particular alleged public good does not mean that we can't imagine some demand revelation scheme that does approximate such optimality. We would need to compare such schemes to voluntary schemes like Schmidtz's. While Schmidtz does not suggest this, I believe clever entrepreneurs might approach optimal provision—and placate Sugden—by repeated use of the assurance contract. For example, everyone signs on for a 100-acre park, and then everyone signs on for 20 more acres, and then there are noncontributors at another 20 acres, etc., with a convergence on some optimally sized park.

And so in the real world, entrepreneurs must seek ways to encourage people to reveal their true demands. A procedure that invokes consent and discourages free riding such as Schmidtz's has a lot going for it when it comes to our world of demand uncertainty. Specifically, Schmidtzian outcomes pass a market test. Perhaps the "transaction costs" in a voluntary scheme are necessary for us to be confident that there really is a demand for a prospective good at a particular price. (Giovanni Montemartini shows how political entrepreneurs work to *generate* free-riding—rather than reduce it—in "The Fundamental Principles of a Pure Theory of Public Finance," in *Classics in the Theory of Public Finance*, by R.A. Musgrave and A.T. Peacock [London: Macmillan, 1958].)

Criticisms of voluntary provision almost always ride on the high horse of better-than-realistic information. Schmidtz has put voluntary provision on the same size horse as sits the public goods argument and found that the joust is a draw. My claim is that, under real world assumptions, we can extend Schmidtz's analysis to show that voluntary provision wins the match.

Reciprocity and the Feedback Theory of Morality

In Chapter 7, "The Morality of a Cooperative Society," Schmidtz covers a lot of ground and makes many interesting points. Space limitations allow me to discuss only my favorite. This point concerns reciprocity in social interaction: "A reciprocator will cooperate if and only if his partner is a cooperator." (p.138) Schmidtz wants to bring this notion of reciprocity into the discussion of moral norms. After invoking John Rawls' definition of society as a cooperative venture for mutual advantage, he states,

> My first premise ... is that, all other things being equal, one candidate for the status of fundamental moral norm is superior to another along a critically important dimension if it is more conducive to the success of this cooperative venture. Superiority along this dimension may not always be decisive, but it surely counts for something, especially in a discussion of the moral norms pertaining to public goods production. (p.141)

Because moral agents choose moral norms independently, the first premise demands that we look at how a suggested moral norm fares in the world, regardless of whatever other agents choose as moral norms. "Because we choose norms for ourselves, *the norms that actually promote cooperation often differ from the norms that would promote cooperation if we were choosing norms for everyone*." (p.141, emphasis in original) Thus, tit-for-tat is a better norm under this reciprocity standard than is nonstrategic altruism, because tit-for-tat helps ensure cooperation whereas nonstrategic altruism encourages free riding. Schmidtz wants us to ask the following question of moral norms: "Is this norm conducive to a cooperative society's success, given how people will react both to it and to agents guided by it?" (p.153) He calls this the "feedback theory" of morality. Schmidtz convinces me that, when we judge norms, we should consider how they fare in a world of alternative norms. Much as Axelrod did with iterated game strategies, we should mentally "run" proposed norms against each other to test which norms lend themselves most to cooperation.

Conclusions

Limits deftly integrates a clear game- theoretic discussion of how and why collective goods can be supplied voluntarily with a lucid explanation of why that fact undercuts the public goods argument for the state. On the way, Schmidtz gives us a useful categorization of justifications for social institutions and a new way to think about moral norms. The book is peppered with insights, only some of which have I discussed here.[8]

Limits is a short book, and so it is an easy book to hand to someone who is being sloppy with a public goods argument for the state. On the other hand, it gives only a partial criticism of the public goods argument. There is a great deal more that has been said and that still must be said about how collective goods can be supplied voluntarily, how governmental provision is inefficient and misguided, and how a voluntary mechanism for collective goods provision may be more conducive to entrepreneurial innovation than a governmental mechanism would be.[9] *Limits* takes the public goods argument and shows that the emperor has no clothes. I believe that Schmidtz has given us some useful weapons in the fight to overthrow the emperor.

Notes

[1] Schmidtz makes nice use of the 2x2 reduced-form payoff matrices often used in game theory. The assurance contract puts zeros for the payoffs in the left column, which makes mutual contributing a dominant strategy except for free-rider effects. I shall not be using the 2x2 matrices, although Schmidtz uses them quite effectively.

[2] In the limiting case, if *all* benefits are excludable, there is no public goods problem. See Harold Demsetz, "The Private Production of Public Goods," in *Journal of Law and Economics*, 13 (October 1970), pp. 293-306; also in *The Theory of Market Failure: A Critical Examination*, edited by Tyler Cowen (Fairfax, VA: George Mason University Press, 1988).

[3] He might allow that assurance contract entrepreneurs would be expected to figure out how large their output should be to maximize the appeal of their product.

[4] We can set aside for a moment the moral hurdle of coercing honest holdouts given governmental provision and smugly enjoy the fact that this is not a moral hurdle faced by voluntary provision.

[5] An excellent discussion of equal versus selective access is in Kenneth Goldin, "Equal Access vs. Selective Access: A Critique of Public Goods Theory," in *Public Choice* 29 (Spring 1977), pp. 53-71; also in Cowen (1988).

[6] An additional point to consider is the adaptability of voluntary or governmental provision schemes to innovations and changes in technology. I've already suggested that governmental provision often prevents people from seeking alternatives. But there is also a factor of inertia more common with governments than with private firms. Important in this light is that historically, most collective and quasi-collective goods now produced by governments were initially produced voluntarily. People saw the need for something and solved it before governments decided they'd like to do it. Voluntary mechanisms, not governmental, were the important innovators. There are examples in law (see Bruce L. Benson, *The Enterprise of Law: Justice Without The State* [San Francisco: Pacific Research Institute for Public Policy, 1990]), education (see Jack High and Jerome Ellig's chapter in Cowen [1988]), lighthouses (see Ronald Coase's chapter in Cowen [1988]), toll roads (see Dan Klein, "The Voluntary Provision of Public Goods? The Turnpike Companies of Early America," in *Economic Inquiry* 28 [October 1990]), and even welfare (see David Beito's "Mutual Aid for Social Welfare: The Case of American Fraternal Societies," in *Critical Review*, Vol. 4, No. 4 [Fall 1990]), as well as other areas yet to be explored by classical liberals.

[7] We can ask what behaviors are rewarded under governmental versus voluntary provision. Schmidtzian entrepreneurs are rewarded for minimizing free ridership and transaction costs. The agents of the state are rewarded by coercing honest holdouts (making the agents more popular with the genuine demanders) and extending the role of the state into other more questionable areas.

[8] *Limits* covers an interesting array of both arguments and fields of scholarship. Schmidtz deals with ethics, political philosophy, game theory, and experimental economics; one of the strengths of the book is its interdisciplinary approach. Political philosophers will be most comfortable with chapters 1 and 7, economists and political scientists with chapters 4 through 6. Chapters 2 and 3 would, I suspect, be especially appreciated by classical liberals. Specialists in these areas might read only selected chapters, though the book is so well written that most will end up reading the entire thing.

[9] I am *not* criticizing Schmidtz for not saying everything that has been said or could be said about voluntary public goods provision; I am just encouraging the reader to read more. A good book to complement *Limits* would be Cowen's *The Theory of Market Failure: A Critical Examination*.

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Crosscurrents

Art and Economics

For many people art is an area of life where economics has nothing to say. Works of art such as paintings, music, and literature are not products like soap or automobiles and cannot (or should not) be produced in the same way, subject to the forces of supply and demand. This is the root of the various arguments used to justify state support of the arts.

William D. Grampp attacks these notions in his new book, *Pricing the Priceless: Art, Artists, and Economics* (New York: Basic Books, 1989). Though the book is concerned primarily with the visual arts, the arguments apply to other art forms as well. Grampp points out that historically most artists have been entrepreneurs, producing artworks explicitly for customers. Grampp adds that this practice has not led to poor quality work nor to slavish adherence to the patron's wishes and loss of artistic independence. He also shows that the purchases of art collectors and the prices of art works are not mystical or peculiar but, like any other market price or purchase, reflect various factors, including supply, demand, and quality. Further, Grampp demonstrates that there is a general agreement among collectors and public as to what constitutes quality and which works have it, that this generally persists over time, and that the reason why most artists are forgotten is that they are eminently forgettable. Contrary to popular belief, the price of an artist's work usually declines after his or her death and is little affected by fashion.

Historically, when art of all types has been produced "like soap," in the market place, the result has been that art is produced to suit the public taste, with a complete range of quality, and with a leavening of what are recognized to be great and original works. Why then do governments support the arts, even when there seem to be numerous examples of this leading to work of questionable quality? For Grampp this is a clear instance of rent-seeking, by some powerful consumers who have their own tastes subsidized and by artists, particularly the less able.

Another question is why public subsidy of arts and the arguments in its favor are so generally accepted by those without direct interests. The answer is probably the success of the notion, derived from the Romantic movement, that art is a peculiar activity and artists a delicate and higher form of life, above mere money-grubbing. For a convincing argument that this is not the case, one should consult Martin Feldstein, ed., *The Economics of Art Museums* (Chicago: University of Chicago Press, 1991). This collection is a treasure trove both of information on the financing and operation of art museums, and on the quite recognizable commercial and financial concerns of their administrators and users. While some of the volume features individuals bewailing the hard times they now face and the problems in getting public support, there is also much realistic discussion of the nature of museums as enterprises selling a product and of ways of improving their sales and marketing techniques.

Feminism Revisited

It is a rare thing these days to find a book discussing feminism which does not assume that the only way to cure women's victimization is to substitute a feminized version of society for the status quo. Wendy McElroy's anthology, *Freedom, Feminism, and the State* (New York: Holmes and Meier, 1991), now in its second edition, stands virtually alone in its exploration of feminist issues from an individualist perspective. Here we see the state, rather than males in general, as the oppressor. For women are to be regarded first and foremost as people who claim *human* rights to life, liberty, and property, and this is where individualist feminism diverges from so much of contemporary feminism: "sameness" is emphasized and "difference" played down (though not ignored, as the chapters on prostitution and abortion illustrate).

In this new edition a few of the original articles have been cut, and a very thoughtful chapter by McElroy on abortion has been added, providing both a timely and incisive discussion of the controversial issue using a rational and systematic application of rights theory.

McElroy begins with a historical overview that is followed by a series of articles drawing on works by both men and women, liberals and non-liberals (but those who nevertheless share a commitment to some aspect of individual freedom), academics, theoreticians, and others. The excerpts are both modern and old, and while they are accessible to those who are unfamiliar with these ideas, they are also useful to readers who already have a knowledge of feminist concerns.

The Influence of Ayn Rand

One particularly important figure in twentieth-century classical liberalism has been Ayn Rand. Her novels have caught the imagination of successive generations of young people, and her writings suggest, *inter alia*, a way of moving from an Aristotelian approach in philosophy to more Lockean ideas about individual rights, and thence to classical liberalism. Her approach has been found suggestive by a small number of professional philosophers, who have attempted to develop arguments along similar lines, in the style of more academic philosophy. One recent and stimulating book in this genre is Tibor Machan's *Individuals and Their Rights* (La Salle, IL: Open Court, 1989). It has now been joined by Douglas Rasmussen and Douglas Den Uyl's *Liberty and Nature: An Aristotelian Defense of Liberal Order* (La Salle, IL: Open Court, 1991).

This work—by the editors of an important critical anthology, *The Philosophic Thought of Ayn Rand* (Chicago and Urbana: University of Illinois Press, 1984)—brings together material upon which they have worked individually for many years, some of which has previously been published in professional journals. They make out a more systematic and rigorous case for this approach than has been attempted before, and their book is also distinguished by engaging with the views of many major figures in analytical philosophy, and with objections that they have raised to approaches like the authors'.

Liberty and Nature will be of particular interest to those attracted to a broadly natural law approach to classical liberalism, and who would like to see this approach developed in a particularly systematic way. It should also be read by those who are not sympathetic to such an approach, as they should find *Liberty and Nature* challenging and provocative. If the book has one fault, it is that it takes for granted the authors' own understanding of Aristotelian metaphysics. As this is not something that will necessarily be too familiar to those schooled within analytical philosophy, one hopes that the authors might produce a companion volume which sets out and defends this approach against contrary views.

The Scottish Enlightenment

Oxford University Press has recently issued a paperback edition of M.A. Stewart's collection, *Studies in the Philosophy of the Scottish Enlightenment* (1990). While the collection is of a rather specialized character, it contains some first-rate material that should be of interest to anyone concerned with classical liberal thought in the eighteenth century and beyond. Roger Emerson offers a wide-ranging discussion of the interrelation between religious, scientific, and moral ideas in the Scottish Enlightenment. Jim Moore and Knud Haakonssen offer differing interpretations of the moral philosophy of Hutcheson and of the continuity—or lack of same—between him and Adam Smith. Richard Sher discusses the social history of the Chair of Moral Philosophy at Edinburgh University, P.B. Wood the interplay of ideas about science and moral philosophy in Aberdeen, and John P. Wright the interplay of metaphysics and ideas in physiology at Edinburgh.

Finally, there are some interesting papers on David Hume: Mike Barfoot has written a fascinating piece on the kind of science that Hume studied at the university, and its relation to discussions by Hume of scientific and related issues in his later works; David Wootton compares Hume's "Of Miracles" with contemporary writings on the same theme; and David Raynor discusses Hume and George Berkeley's *Three Dialogues*. All told, the papers in this volume not only provide much interesting reading in their own right, but also provide much useful background to contemporary scholarship on the Scottish Enlightenment.

The Costs of Prohibition

Increased scrutiny of the war on drugs in America has recently led some observers to question the wisdom of this policy, and to begin exploring alternative approaches. As a result, discussions of the legalization of the sale and use of narcotic drugs by adults are now attracting more attention than they have in years past.

The authors of two recent works have closely examined the effects of the war on drugs, and have each discussed legalization from a different perspective. In his article "A Drug Free America—Or A Free America?" (*U.C. Davis Law Review*, Vol. 24, [1991], pp.617-636), David Boaz succinctly summarizes all of the main arguments about the negative effects of drug prohibition: increased crime, "harder" and more dangerous drugs and drug combinations, massive expansion of state power and erosion of individual liberty, and on top of all that, complete failure to achieve the ends of prohibition, those being a cessation or at least reduction of drug use. Although Boaz makes reference to economists' arguments, the main thrust of his arguments is a moral one, concentrating on the way the "drug war" threatens individual rights, corrupts the agencies of government and, above all, undermines the idea of personal responsibility through the mischievous doctrine of addiction.

By contrast, Mark Thornton's *The Economics of Prohibition* (Salt Lake City, UT: University of Utah Press, 1991) puts much of this argument on a different footing by developing an economic model derived from Austrian economics and Public Choice theory which tries to explain the origins, nature, and consequences of prohibition in general—the argument applies as much to bans on activities such as gambling as to the outlawing of substance abuse.

For Thornton, "prohibition is designed to curtail the production, exchange, and consumption of a good *with the ultimate aim of extinguishing it*" (emphasis added). There are two key problems with this, both highlighted and explained by economic analysis. The cost of enforcing prohibition is subject to the law of diminishing marginal utility, and in reality this makes it impossible to come anywhere near "extinguishing" the prohibited activity. The cost of enforcing prohibition starts to cut into other, more desirable or productive uses of resources and runs up against limits of practicality—you can't have the entire police force, FBI, and Coast Guard do nothing but enforce prohibition. So in reality economic forces will generate an acceptable level of illicit consumption, arrived at by trading off the costs of enforcement against the costs of the usage. Moreover, prohibition inevitably produces the negative results identified by Boaz. Thornton shows, clearly and simply, how these necessarily result from the economics of prohibiting the sale and use of a product for which there is a demand. Most serious is the increased crime directly caused by prohibition (as Thornton and Boaz both point out, the murder rate after the repeal of alcohol prohibition decreased for 11 consecutive years). Next in importance is the decline in quality and the increase in potency of prohibited substances: the 1920's saw a big move from beer to spirits, and the present "drug war" has produced a steady move towards ever more potent and dangerous narcotics.

The most significant element of the book is the part derived from Austrian economics. Thornton argues that the real costs of drug use would, in the absence of prohibition, lead the discovery mechanisms in the market to produce voluntarist solutions to these problems. For example, the observable trend in non-prohibited substances such as tobacco and alcohol is for potency to diminish and less harmful alternatives to be produced—the exact opposite of the trend under prohibition. In the nineteenth century in both England and America the market produced institutions such as the saloon and the pub which worked to reduce the desperate problems of alcohol abuse which existed at the start of the century—and which reappeared under prohibition. By contrast, the bureaucracy involved in prohibition acts to stifle market mechanisms except those operating in the distorted black market caused by prohibition.

Beito and Smith Win Urban History Award

David Beito and Bruce Smith recently received the Urban History Association's award for Best Scholarly Journal Article Published in 1990. The article appeared in the *Journal of Urban History* 16: May 1990, pp. 263-303, and is entitled "The Formation of Urban Infrastructure Through Non-Government Planning: The Private Places of St. Louis, 1869-1920." Anyone desiring a copy of this article may contact the editor of the *Humane Studies Review*.

Reading (Continued from page 1)

My point is that literature sometimes studies it too. Wily Odysseus, the master of subtle dealing, enacts the wanderings of a Greek trader. Robert Frost's poem about mending a wall (his stone-age workmate said, "Good fences make good neighbors") is about a farming chore but also about its meaning or lack of meaning and about our view of the meaning. Look at the beginning of *The Merchant of Venice*, one of many instances in a play "about," among other things, accounting:

> *Salarino*: . . . . I know Antonio
> Is sad to think upon his merchandise.
> *Antonio*: Believe me, no; I thank my fortune
> My ventures are not in one bottom trusted,
> Nor to one place; nor is my whole estate
> Upon the fortune of this present year:
> Therefore my merchandise makes me not sad.
> *Salarino*: Why, then you are in love.
> *Antonio*: Fie, fie!

Yet Antonio's ordinary business seems by Act III to have gone badly, and his loan, too. Bassanio asks, "But is it true, Solanio?/Have all his ventures failed? What, not one hit?/ From Tripolis, from Mexico, and England,/ From Lisbon, Barbary, and India?/ And not one vessel 'scape the dreadful touch/ Of merchant-marring rocks?" "Not one, my lord." Poets and novelists write "about" war, love, politics, religion, and always about writing itself. But they write also on occasion about financial crises and daily work.

Such writings denote the meanings of ordinary life, not as mottoes hung and forgotten on the wall but as revisionings—literally, visions seen again, and again, and again, on each reading. To the economist's definition of economics the literary critic Northrop Frye would add, as he says in *The Educated Imagination* (Bloomington: Indiana University Press, 1964, p. 140): "The fundamental job of the imagination in ordinary life . . . is to produce, out of the society we have to live in, a vision of the society we want to live in."

The vision of the society we want to live in can be utopian and socialistic; or else it can be local and capitalistic. That is, it can exhibit the nature of man under socialism, never seen but vividly imagined, the vision provided by nineteenth-century intellectuals to haunt the twentieth century. Or it can exhibit the Edinburgh townsman, encountered yesterday in the street, the vision of eighteenth-century intellectuals which we may hope will guide the twenty-first century. The one is utopian in its root sense: *ou topos*, no place. The other is particular to a locale, tried. Both are visions of the society we want to live in and both are revisioned in literature.

Poets write about poetry, I say, even when writing about the economy. Here is Frost, in "The Tuft of Flowers," first published in 1915 (later in E.C. Lathem, ed., *The Poetry of Robert Frost* [New York: Holt, Rinehart, and Winston, 1968, pp. 22-23]), revisioning what poetry has to do with work, locally, in the here and now: "I went to turn the grass once after one/ Who mowed it in the dew before the sun. . . . But he had gone his way, the grass all mown,/ And I must be, as he had been—alone, / 'As all must be,' I said within my heart,/ 'Whether they work together or apart.'" Yet a butterfly causes him to see a tuft of flowers left by the mower. He had left it for no payment, "Nor yet to draw one thought of ours to him,/ But from sheer morning gladness at the brim." In a recording of the poem Frost remarked of "sheer morning gladness at the brim" that it was "a definition of poetry." Thus the social character even of poetic work: "glad with him, I worked as with his aid,/ And weary, sought at noon with him the shade; . . . . 'Men work together,' I told him from the heart,/ 'Whether they work together or apart.'"

The word *poema* in Greek means "a thing crafted." Frost the craftsman was suspicious of grand revisionings of the economy—"Yes, revolutions are the only salves./ But they're one thing that should be done by halves" ("A Semi-Revolution"). He saw a job of grass-turning or apple-picking as a local and literal thing made. We work together in the economy, whether we work together or apart, which is the reason to care about its imaginative revisioning. We buy and sell, and in the sweat of our brows earn our bread.

Poets and novelists write "about" war, love, politics, religion, and always about writing itself. But they write also on occasion about financial crises and daily work. Such writings denote the meanings of ordinary life, not as mottoes hung and forgotten on the wall but as revisionings—literally, visions seen again, and again, and again, on each reading.

The plan, then, would be to select the best that has been thought and written about the ordinary business of life. Some writers, like Frost, could fill a book themselves, so often did they reflect on work and trade, as in "New Hampshire," published in 1923 (and in Lathem, p. 164): "Do you know,/ Considering the market, there are more/ Poems produced than any other thing?/ No wonder poets sometimes have to *seem*/ So much more businesslike than businessmen."

Other poets and novelists deal rarely with the economy. T.S. Eliot does just once, when casting a traveler to Christ's birth as making a business report, complaining of the assignment, the prices, and the accomodations ("Journey of the Magi," in Eliot, *The Complete Poems and Plays 1990-1950* [New York: Harcourt, Brace & World, 1952, pp. 68-69]). Eliot was a banker and publisher, but like most moderns he separated his art from his business. The successor to Eliot as the most studied American poet, Wallace Stevens (1879-1955), might have written economic poetry in abundance, as a surety bond lawyer for Hartford Accident and Indemnity Company from 1916 until his death, but wrote in fact none. W.H. Auden, though socially conscious in a way that neither Eliot nor Stevens was, produced only a handful of economic poems.

Of course one could, as the literary people put it, "be reductive" and stick everything into the economy, thereby harvesting every poem as "basically" economic. After all, the host of golden daffodils that Wordsworth saw in never-ending line along the margin of a bay were some farmer's field infected with weeds, or else a venture in the cut flower trade. Various other reductions are possible. Literature can be "basically" psychological or personal or sexual or social. Yeats' poem "Easter 1916" can then be cast into the category of economic because it is political and, after all, politics is basically economic.

The better selection, however, would be non-reductive. Indeed in a particular sense it would be superficial, for a reason. A poem or story can be taken as "about" the economy if it speaks on the surface about the matters that concern businesspeople, trade unionists, craftsmen, economists, housewives, and other workers and their theorists. If such a poem or story is read by such economic people they will start intrigued. If it is good literature they will stay.

Good writers of course say more than is on the surface. (That is not to say that they write in order to be decoded in a summarizable message, which is the view expressed in Richard Posner's lamentable *Law and Literature* [Cambridge: Harvard University Press, 1988]; it is the theory that literature is a picture puzzle, like those in the children's book "Where's Waldo?") The below-surface meaning is why I keep putting uncomfortable quotation marks around the word "about," as in "about the economy." "More than is on the surface" says merely that the meanings coexist at different levels and that literature enacts its meaning as much as saying it. The anthology would connect the economic surface of people's lives to the tradition of literature. The purpose is to entice economic people into literature.

There is a lot of literature of high quality about the economy. An anthology should prefer complete works to snippets, yet some snippets are hard to resist. Consider Matthew Arnold's portrait of a trader fleeing the ruck of the eastern Mediterranean, at the end of Arnold's decidedly uneconomic, even anti-economic, poem, "The Scholar Gypsy": "To where the Atlantic raves/ Outside the western straits; and unbent sails/ There, where down cloudy cliffs, through sheets of foam,/ Shy traffickers, the dark Iberians come;/ And on the beach undid his corded bales."

Poetry is one type; novels are another. Whole novels deal with the economy, as Defoe's *Robinson Crusoe* or *Moll Flanders* do. Jane Austen's supporting players are economic people before the phrase, maximizers on the market for marriage. Dickens is of course a relentless describer of the worst of capitalism, most relentlessly in *Hard Times*. The novels can be snipped to fit: Crusoe choosing what to save from the wreck, the exercise of choice under constraints; or Steinbeck's description of the labor camps in California in *The Grapes of Wrath*; or bargaining scenes from the sagas of the Icelanders, a commercial and heroic people. Alessandro Manzoni's novel *The Betrothed* (1825-26) is memorized by Italian school children as a model of Tuscan. Manzoni was a classical liberal, and devotes an eloquent chapter (XII) to showing the effects of price controls during a famine.

But wait a minute. Work and play differ, don't they? The sweat of our brows is one thing, the spiritual Eden of literary art another, correct? The economy is matter, literature is mind, right? We work by day as lawyers or ditchdiggers and then cleanse our souls of an evening with golden daffodils recollected in tranquility, *n'est ce pas*?

No, not right, not correct, *non*. If literature often cannot be summarized without loss, my theme can: It is, "The dichotomy between the economy and the spirit is bunk."

If literature often cannot be summarized without loss, my theme can: It is, "The dichotomy between the economy and the spirit is bunk."...The dichotomy is nutty and hurtful, and it is about time we got rid of it.

An anti-economic line in much literature has enforced the dichotomy. The bard scorns the mere tradesman standing at the door of the banquet hall. An ancient poetic convention splits the two, work and play, as though done by different classes, one the slaves, the other the aristocrats. The sneering dichotomy between work and play celebrates a leisured class of poets, priests, and philosophers resting on a mob of mere workers. "*Odi profanum vulgus et arceo*, I hate the uncouth mob and fend it off," sang Horace (*Odes* 3.1) in the language of religion, concluding with an anti-economic query in the language of the marketplace: "*cur valle permutem Sabinal divitias operosiores?* Why should I exchange my Sabine valley for the great trouble of riches?" The vulgarities of work and technology and science are supposed to have nothing to do with their own meaning, supplied from the outside by religion and poetry and music.

The matter/mind split dates from the Greeks, and especially from Plato, exemplified for him in the split of slave from master, and the mere citizen from the aristocrat. In the seventeenth century, when one might think the ever-rising middle class would be finding some way around it, the dichotomy was revived as science versus practice. One sees the result today in the sneers that theoretical physicists reserve for engineers (and for everybody else). The mathematicians and theorists come mostly from the upper middle class or the aristocracy itself; from the rest, disproportionately, come the engineers and entrepreneurs.

The dichotomy is nutty and hurtful, and it is about time we got rid of it. Anyone who has proven in school a mathematical theorem and also written a rock lyric knows that the two have similarities. Anyone who has laid hot-top for the Highway Department and made a pot on a wheel at the community college knows that the pleasures of plasticity are one. Anyone who has sold a car secondhand and read Lincoln's *Second Inaugural* knows that the joys of exercising the language for persuasion are the same.

It is hurtful for the nine out of ten adults who work in home, office, or factory to be told their main occupation is beyond the reach of poetry and fiction. No wonder they turn to other sources of lyric and myth, to rock music and country, the TV soaps and the National Football League. The literary people keep telling

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them that what they do is "alienating" and that the only real living happens in leisure time and in libraries.

Eric Hoffer, the San Francisco dock worker and sage, spoke often to the contrary, as someone in a position to know. Thus *The Ordeal of Change* (New York: Harper and Row, 1963, p. 34):

> it is mainly by work that the majority of individuals prove their worth and regain their balance .... No one will claim that the majority of people in the Western world, be they workers or managers, find fulfillment in their work. But they do find in it a justification for their existence. The ability to do a day's work and get paid for it gives one a sense of usefulness and worth.

Or again, in *The Temper of Our Time* (New York: Harper and Row, 1967, p. 13):

> There is a considerable literature on the barbarizing and dehumanizing effects of the machine; how it turns us into robots and slaves, stifles our individuality, and dwarfs our lives. Most of the indictments of the machine come of course from writers, poets, philosophers, and scholars—men of words—who have no first-hand experience of working and living with machines. . . . The proficient mechanic is an alert and intuitive human being. On the waterfront one can see how the ability to make a fork lift or a winch do one's bidding with precision and finesse generates a peculiar exhilaration.

In other words, the anthology would lean against the false dichotomy of (mundane) work and (spiritual) life. In *Justice as Translation: An Essay in Cultural and Legal Criticism* (Chicago: University of Chicago Press, 1990) James Boyd White, a legal and literary scholar of note, has asked the right question: "Can we learn to produce texts that are more 'integrated' in the sense that in them we put two things—two systems of discourse, two sets of practices—together in such a way as to make a third that transforms our sense of both? . . . Can we find ways to connect the way we talk professionally with the ways we talk in ordinary life?" The anthology would try to put the literary and the economic systems of discourse together, to make a third that transforms our sense of both.

A selection will of course depend on a theory of the economy. The dominant theory of the economy in departments of literature these days is Marxist, and for about a century even intellectuals without much enthusiasm for state socialism have thought It's All in Marx. Alarmingly, an English professor who wants to learn more about the economy will turn to Lukacs, Adorno, or Eagleton, not to Friedman, Arrow, or Samuelson. She does not even turn to Marxoid writings that recognize the power of non-Marxist economics or the error of Marxist economic history, such as Robert Heilbroner's or John Elster's. If she is serious she will read back to *Capital* and *Economic and Philosophical Manuscripts*, but never to Menger or Marshall. A well-known Marxist critic admitted to me recently—to her credit she was embarrassed at the thought—that she had read Marx's attack on Adam Smith with care but not a page of Adam Smith.

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A "new economic criticism," as the critic Martha Woodmansee has called it, is redressing the balance. Woodmansee herself has written most illuminatingly on "The Genius and the Copyright" (*Eighteenth-Century Studies* 17, Summer 1984: 425-448), explaining how the romantic notion of the lone author has colored modern law. Others in this line are Marc Shell (*The Economy of Literature* [Baltimore: Johns Hopkins University Press, 1978]; *Money, Language and Thought* [Berkeley: University of California Press, 1982]), Catherine Gallagher (*The Industrial Reformation of English Fiction* [Chicago: University of Chicago Press, 1985]), and especially Kurt Heinzelman (*The Economics of the Imagination* [Amherst: University of Massachusetts Press, 1980]), who is remarkably sophisticated about economics-without-Marx. They all shift their gaze from production and reproduction (namely, Marxism) to consumption and growth (namely, Smithism). "Consumption," said Smith, to the applause of most economists, "is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer."

The anthology would try to put the literary and the economic systems of discourse together, to make a third that transforms our sense of both.

From the economic side, too, there are signs of literary life, such as Don C. Lavoie, ed., *Economics and Hermeneutics* (London: Routledge, 1990). There is no need to cast out the Marxist writings; but they do need a great deal of supplementation. As long as the supplementation is broad church not much harm is done, even to Marxist sensibilities. "The ordinary business of life" covers a lot of ideological ground. There is no need to be dogmatic.

Of course, I have views. On Marxism they are well expressed again by Hoffer: "Marx never did a day's work in his life, and knew as much about the proletariat as I do about chorus girls" (*Before the Sabbath* [New York: Harper and Row, 1979, p. 60]). But in my youth I was a Marxist and have felt the romance of revolution. The socialists have by far the best songs: "And was Jerusalem builded here/ Among these dark satanic mills?"; "For a' that, and a' that,/ It's coming yet, for a' that,/ That man to man the warld o'er/ Shall brothers be for a' that"; "From San Diego up to Maine/ In every mine and mill/ Where workers strike and organize,/ That's where you'll find Joe Hill."

Fairness in selection, against my own bias, is easy in the present case, because literary people have not been on the whole enthusiasts for markets. The word-people of course favor words. They tend to think that explicit planning, which is word-rich, is therefore to be preferred to anonymous markets. (They have not usually recognized that markets in fact live on the tongues of men and women: one quarter of national income at present is spent on persuasion, as Arjo Klamer and I have discovered recently.)

So most of the economic thinking of literary people has been socialist, if not positively Stalinist, in its hostility to free exchange. Thus Arthur Hugh Clough's skillful poem of 1862, "The Latest Decalogue," when the literary socialists were beginning to win the war against capitalism: "Thou shalt have one God only; who/ Would be at the expense of two?/ No graven images may be/ Worshipped except the currency," and so forth and so on, down to, "Thou shalt not covet, but tradition/ Approves all forms of competition." And Ogden Nash, when the clerisy of the pen had finally won: "Man must labor,/ Man must work./ The executive is/ A dynamic jerk." The materials for a selection, if chosen by a literary standard, will lean against my predispositions.

Yeats says somewhere in his *Autobiography* that "We should ascend out of common interests, the thoughts of the newspapers, of the market place, but only so far as we can carry the normal, passionate, reasoning self." There it is again, that notion that we "ascend" to a realm of poetry out of the marketplace. But Yeats had the sense to see that the normal, passionate, reasoning self must not be left behind. The crafter of literary things will speak of labor and valuation even in rejecting it, as did, for a last example, that fountain of pure poetry, Dylan Thomas ("In My Craft and Sullen Art," from *The Collected Poems of Dylan Thomas* [New York: New Directions, 1946, p. 142]):

> In my craft or sullen art
> Exercised in the still night
> When only the moon rages
> And the lovers lie abed
> With all their griefs in their arms,
> Not for ambition or bread
> Or the strut and trade of charms
> On the ivory stages
> But for the common wages
> Of their most secret heart.
>
> Not for the proud man apart
> From the raging moon I write
> On these spindrift pages
> Nor for the towering dead
> With their nightingales and psalms
> But for the lovers, their arms
> Round the griefs of the ages,
> Who pay no praise or wages
> Nor heed my craft or art.

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Explaining the Rise of Fraternal Insurance: The Economics of Asymmetric Information

In order to explain the rise of fraternal insurance, we must ask ourselves what advantage these organizations may have had over commercial competitors. The answer to this question is likely to lie in the peculiar economic problems of insurance organizations.

Insurance contracts are made in an environment of asymmetric information. Simply stated, the insured has information about the probability that he will make a claim, information that is not so readily available to the insurer. Using the terminology of Kenneth Arrow's "The Economics of Agency" (in John Pratt and Richard Zeckhauser, eds., *Principals and Agents: The Structure of Business* [Boston: Harvard Business School Press, 1985]), the asymmetry takes two forms: hidden action and hidden information.

Hidden action refers to efforts taken by the insured that are not observable by the insurer, and that affect the probability that a claim will be made. For example, whether or not one smokes affects the probability that a health insurance claim will be made. But the insurance company is not in a position to observe this behavior. In fact, the availability of insurance may make the insured even more likely to smoke since the existence of insurance partially shields him from the consequences of his actions. The problems created by hidden action are referred to in the insurance literature as moral hazard.

Hidden information refers to facts known by the insured that are not observable by the insurer, and that affect the probability that a claim will be made. Suppose that a given population of insureds can be segmented into two groups, one with a high probability of making a claim, and one with a low probability of making a claim. Ideally the market would be segmented, with the high risk group paying more for their coverage. However, if because of hidden information it is impossible to tell which group a given insured belongs to, members of the high risk group would purchase the cheaper policy designed for the low risk group. The price of the low risk policy would rise as the number of claims increased, thus imposing an externality on the members of the low risk group. The technical term for this phenomenon is *adverse selection*. The classic work on adverse selection is George Akerlof's "The Market for Lemons" (*Quarterly Journal of Economics*, Vol. 84, No. 3 [1970]).

In order to explain the ascendance of fraternal insurance, then, we could ask whether these organizations had advantages over competing institutions in overcoming the problems of moral hazard and adverse selection.

The problem of moral hazard is studied by economists who deal with the principal-agent theory. For our present purposes, a principal can be defined as the party least likely to be informed in a transaction, in this case the insurance organization. The agent is the party most likely to be best informed in the same transaction, in this case the insured. (For further discussion of principal-agent theory, see Eric Rasmusen, *Games and Information: An Introduction to Game Theory*, New York: Basil Blackwell, 1989.) The trick, then, is for the principal to design a contract that will induce the agent to act in the principal's best

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interest. In the presence of moral hazard, a less than optimal contract can be designed that will balance the insured's need for insurance against the resulting disincentives. These second-best contracts will generally have certain characteristics. First, they will shift some of the risk back to the insured in the form of a "deductible," a portion of the total claim amount that must be paid by the insured. Second, the insurer will seek information from which he may infer the claims rate of the insured, and will attempt to monitor the insured to reduce inference errors. There is obviously a limit to what the insurer can obtain through these activities; certain information will be too costly to obtain, and certain monitoring procedures too costly to engage in. Two important works on optimal contracts in the presence of moral hazard are Stephen Ross' "The Economic Theory of Agency: The Principal's Problem" (*American Economic Review*, Papers and Proceedings, 1973), and Michael Spence and Richard Zeckhauser's "Insurance, Information, and Individual Action" (*American Economic Review*, Papers and Proceedings, 1971).

These developments in principal-agent theory will help to explain the ascendance of fraternal insurance *if the fraternals possessed an advantage over commercial firms in the design of these contracts*. Recall that the main techniques for designing the optimal contract, besides deductibles, are statistical inference of claims probabilities and monitoring. In the heyday of fraternal insurance, firms did not generally have available to them the sophisticated actuarial data that insurers use today to infer expected claims rates. So we would expect that monitoring would be the crucial factor in the overcoming of moral hazard during this historical era. And because of their relatively small size and cultural homogeneity, we could expect the fraternals to have an advantage over commercial insurers in monitoring the behavior of their members.

Adverse selection can be overcome if the integrity of risk classes can be preserved. We know that the fraternal insurance organizations were typically segmented along racial and ethnic lines. There were fraternals for native whites, native blacks, Poles, Slovaks, Hispanics, and for all the other ethnic groups that populated the urban ghettoes of early industrial America. During this era, we would expect these ethnic groups to have distinctive demographic profiles, and thus to form distinct insurance-risk classes. For example, we would expect members of a Slovakian fraternal in the Chicago ghetto to have similar jobs, similar family structures, etc. To the extent that the ethnic groups of the era formed distinct risk classes, the membership restrictions of the fraternals put them in a unique position to ameliorate the problem of adverse selection. (For a description of the proper risk classification and pricing of insurance, see Kenneth Abraham's *Distributing Risk: Insurance, Legal Theory and Public Policy* [New Haven: Yale University Press, 1986], and Gary Becker and I. Erlich's "Market Insurance, Self-insurance, and Self-protection," in *Journal of Political Economy*, Vol. 80 [1972].)

It is also possible to consider the problems of asymmetric information in terms of game theory. The classic game theory tool used to explore such problems is the "Prisoner's Dilemma". It may be possible to model the decision of whether to cooperate (make only legitimate claims) or to default (make fraudulent or avoidable claims) in terms of this dilemma. For those readers unfamiliar with the Prisoner's Dilemma, imagine that you are one of a pair of prisoners, each unable to communicate with the other. Both of you are made the following offer: testify against the other prisoner and, assuming the other prisoner remains silent, you will go free (the other prisoner will receive a ten-year sentence). If you and the other prisoner both remain silent, you will each receive a one-year sentence. However, if you remain silent while the other prisoner testifies, you will receive a ten-year sentence (the other prisoner will go free), while if you both testify, you will each receive a nine-year sentence.

It is clear that the most rational thing would be for both of you to remain silent, thus gaining the minimum one-year sentence available to both of you. However, unable to communicate, you face two problems. The first is one of assurance: how can you know what the other prisoner will do? The rational thing to do, faced with this uncertainty, is to testify, thus assuring yourself of the smaller nine-year sentence in the event that the other prisoner testifies as well. But let's assume that you have avoided the assurance problem, by arranging beforehand how you would act if arrested, or simply because you know your partner well enough to know that he will not testify against you. You are now faced with the second problem, the temptation to become a free rider. In short, your knowledge that your partner will not testify leaves you with the opportunity to testify against him, thus gaining freedom at his expense. Because of the problems of assurance and free-riding, it is alleged to be impossible for individuals in this situation to behave in the most rational manner. (This is admittedly a sketchy definition of the Prisoner's Dilemma, and probably suffers from a lack of graphic representation. For a more thorough discussion of the model, and its relation to public goods in general, see David Schmidtz's *The Limits of Government: An Essay on the Public Goods Argument* [Boulder, CO: Westview Press, 1991], as well as the review of that book in this issue.)

The usual solution to the Prisoner's Dilemma, then, is that no one will cooperate. However, an interesting thing happens when we consider the case of repeated games. Prisoner's Dilemma-type defaults can be overcome in situations where individuals must interact on numerous occasions. Here a sort of "tit-for-tat" mentality may develop among participants. For instance, let's say that two people get together for the purpose of insuring each other against some possible tragedy. They agree that if this tragedy occurs to either or both of them, they will share the costs. If this tragedy actually does occur we might expect, based on the preceding discussion, that the non-afflicted party will at least entertain the temptation to default. What might keep him from doing so? Quite simply it is the knowledge that by defaulting he would eliminate any possibility for a long-term insurance relationship. There would be no chance of collecting from his partner if he himself should ever suffer a similar tragedy.

This dynamic becomes a bit more problematic when we consider groups larger than two. As the number of group members grows, and the number of transactions increases, the possibility of identifying defaulters would seem to diminish. However, the emergence of a phenomenon known as a "reputation mechanism" can eliminate this problem, by affording knowledge of an individual's transaction history and the likelihood that he will default. (For a concise exposition of the reputation mechanism see David Kreps, Paul Milgrom, John Roberts and Robert Wilson's "Rational Cooperation in the Finitely Repeated Prisoner's Dilemma," in *Journal of Economic Theory*, Vol. 27, 1982.)

Because of their small size and homogeneity, the fraternal organizations may have been in a better position to identify shirkers than were commercial firms. Also, members of fraternal organizations would be less likely to jeopardize their fraternal ties because the organizations performed other functions that they also valued. (For a broader understanding of cooperation from a game-theoretic perspective, see Robert Sugden's *The Economics of Rights, Cooperation and Welfare* [New York: Basil Blackwell, 1986]. Another innovative treatment of the prisoner's dilemma and cooperation is Schmidtz's *The Limits of Government, op. cit.*)

Explaining the Decline of Fraternal Insurance

At the height of fraternal insurance in America, consumers could choose from a wide array of insurance arrangements. In addition to fraternal insurance, a consumer could choose commercial insurance similar to what is common today. Industrial insurance, with premiums collected door-to-door on a weekly basis, was another low cost option for the workingman. Many trade unions also offered insurance. Today's insurance industry, however, is characterized by a much more restricted range of options. Indeed, consumers have very little choice in what has become a two-tiered system consisting of, first, costly commercial insurance usually linked to employment, and second, the government's "social safety net". Disentangling the factors and processes that led from a situation with a considerable number of options to this restrictive two-tier system is a daunting task.

As you recall, it was suggested that the rise of the fraternals can be at least partially explained by their superior ability in handling the problems of asymmetric information. One possible explanation for their decline, then, is a diminution of these advantages relative to competing institutions. For example, one could argue that the cohesiveness of American communities declined with the emergence of our modern, mobile society. This would have the effect of diminishing the fraternals' natural advantage in monitoring. Also, the development of modern actuarial science would decrease the general importance of small-group monitoring in the insurance relationship.

The decline of community cohesiveness might also imply that the groups would no longer constitute distinct risk classes, so their advantage in ameliorating adverse selection would be undermined. This argument is especially strong for the ethnic fraternals formed by immigrant groups in the urban ghetto. We would expect the cohesiveness of these communities to decline as the immigrants assimilated.

However, just because the decline of fraternal insurance coincided with the decline of community does not mean that one caused the other. They may instead have occurred at the same time because they were both caused by another factor. Below are suggestions of some possible factors, though it should be stressed that here again is an area in which much more research is needed.

One such factor may be the rise of the modern welfare state. Fraternal insurance was especially popular among poor blacks and immigrants. This suggests that replacement of this insurance by mandatory or subsidized government social insurance may at least partially explain the decline of the fraternals among the poor. To what extent the fraternals were displaced by the burgeoning welfare state is not well documented. Social historians have noted, however, a general decline in community and mutual aid among the poor that accompanied the rise of the welfare state. David Beito, in the above-mentioned "Mutual Aid for Social Welfare," also points out that the introduction of workman's compensation has been linked to the dropping of disability insurance by many fraternals. Similar phenomena may be observed in the U.K. David Green has documented in detail the role of the National Health Act (providing state-financed medical care) in forcing out fraternals there. (See *Working Class Patients and the Medical Establishment* [New York: St. Martin's Press, 1985]. For a theory of the welfare state as a political strategy, see the Marxist-oriented essay "The Great Society as Political Strategy," by Frances Fox Piven, in Piven and Richard Cloward, *The Politics of Turmoil: Essays on Poverty, Race, and the Urban Crisis* [New York: Pantheon Books, 1974].)

Another factor that may have contributed to the decline of fraternal insurance was the imposition of wage controls by the federal government during the second world war. To get around these wage controls, employers offered benefits which were not considered taxable income (and hence not violations of the wage controls). These benefits came in the form of, among other things, health insurance. Because income is taxed and benefits are not, it is in the best interest of both employer and employee for the employee to receive as much as possible of his or her salary in the form of benefits, thus sheltering this portion of the salary from income and FICA taxes. This employer-provided non-taxed commercial insurance had a competitive advantage over other systems, and probably contributed to the decline of fraternal arrangements.

Still another factor that may have contributed to the decline of fraternal insurance is price regulation. By the 1890s, a movement was underway to impose a mandatory price structure on the fraternals. Beginning in 1891, the National Fraternal Congress themselves drafted a series of bills that, among other things, compelled all fraternals to charge rates no lower than those indicated by a mortality table they had computed. These bills were introduced into state legislatures for consideration. By 1919, 40 states had some form of NFC model bill in effect.

According to Walter Basye, the NFC did this in order to ensure that all fraternals were operating on a sound actuarial basis by setting a floor on the prices they could charge (*History and Operation of Fraternal Insurance* [Rochester: The Fraternal Monitor, 1919]). However, it is not known whether the fraternals were unsound nor indeed whether they had a significant insolvency rate. The fact that this legislation was promoted by the NFC, and opposed by the commercial insurance industry, suggests that the NFC was hoping to undercut efforts to bring fraternals under the more extensive regulation already in effect on commercial insurance firms. However, it could also be the case that the NFC was attempting, through the passage of this legislation, to promote cartel pricing. Here we

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have another group of issues awaiting the attention of serious and able scholars.

The economic effects of a price floor are well known. If the price floor is set below any price observed in the market, the price floor is trivial. But if some insurers are pricing below the floor, the low end of the market is eliminated. The imposition of the standard mortality table would most likely have the additional effect of flattening rates, both between fraternals and commercial firms, as well as among fraternals.

One last possible explanation of the decline of fraternal medical insurance particularly is medical licensure requirements. The fraternals provided health insurance by hiring a society doctor who provided care for members on a fixed fee basis. (This was also true of British and Australian friendly societies.) This practice came under heavy attack from the medical profession on the grounds that it was "degrading" to doctors and that society doctors were seriously underpaid. And because medical associations like the AMA in America and the BMA in Britain control the licensure of doctors, they were able to use their power to eliminate the practice. This process was documented for Great Britain in David Green's *Working-Class Patients and the Medical Establishment*, and for Australia in Green and Lawrence Cromwell's *Mutual Aid or Welfare State* (Sydney: George Allen and Unwin, 1984).[1]

There are, then, a number of competing explanations for the decline of fraternal insurance. Which of these explanations proves decisive will tell us a great deal about the ultimate significance of these institutions to the free society. If it can be shown that they were victims of displacement by the welfare state, or that they were regulated out of business, their decline is highly significant in terms of demonstrating how the government forces out institutions which would provide the same goods and services, but on a voluntary basis and more responsively to the needs of their constituencies.

Even if it turns out that the decline of the fraternals was a natural response to changing market conditions, their rise and fall is important in terms of understanding how a free society might work. In either of these scenarios, there is much to be learned from further study of the fraternal insurance industry. Historians and sociologists can look more closely at the conditions that lead to the rise of fraternal organizations, and how they functioned in the different groups in which they were found. How prevalent they were, and in how many different forms, are problems the solutions to which require further work. For political scientists and economists, there is the question of the effects of actions by the state, and why these actions were taken to begin with. Economists need also to look at the viability of fraternal organizations, and how they compare to the seemingly more limited range of options available today. So there is obviously enough work to keep scholars busy for some time, and the answers to these questions cannot help but give us new insights into the function of a free society.

Notes

[1] In the United States, the AMA controls the education and licensure of doctors, but American economists have differing opinions about whether the AMA engages in monopoly or cartel behavior. Kenneth Arrow, in "Uncertainty and the Economics of Medical Care" (*American Economic Review*, Vol. 53, No. 5, 1963), recognized the potential for cartel behavior, but he saw the education and licensing restrictions as necessary to ensure consistent high quality care because patients do not know enough about medicine to know whether or not they are receiving good care. Thus, "the laissez-faire solution for medicine is intolerable."

In contrast, Reuben Kessel argues that medical licensure is used to extract rents for doctors both by restricting the supply of doctors, and by circumscribing certain contractual relationships between doctors and their patients. See his *Essays in Applied Price Theory* (Chicago: University of Chicago Press, 1980). For an excellent description of the ways in which government aids the formation of monopoly, including licensing restrictions, see *The Political Economy of Monopoly* (Baltimore: The Johns Hopkins Press, 1952) by Fritz Machlup. The point is that licensure and state regulation may exacerbate, or even cause, the informational problems facing consumers in medical markets.

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