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# **The Private Provision of Public Goods:**

## **The History and Future of Communal Liberalism**

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Paper presented at the international colloquium "Liberalism and Communal Self-Administration", organized by the Liberal Institute of the Friedrich Naumann Foundation for Freedom, Potsdam, 18 September 2009.

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## Terminology of Private and Public Goods

My book *Public Goods and Private Communities*, published in 1994, was one of the first economic studies of communal self-administration. Today, there is a growing interest in private communities and contractual governance.

When we speak of private communities and the private provision of public goods, we need to first clarify what is private versus what is public. As the author of the book *Dictionary of Free-Market Economics*, which has an edition in German, I think it is important to first be clear on the meanings of these terms.

In English, unfortunately, the terms "private" and "public" have two distinct but often conflated meanings. The term "public" means a group of people. Any group of two or more persons is a public, as in the term, "open to the public." The term "public" originated in the French word "public," meaning "pertaining to the people." It stems from the Latin term "publicus," from "populus," people.

The word later obtained a second, unfortunate, meaning. The "public sector" is the governmental part of the economy, as in "public school" or "public library." The term "public school" originally meant a school intended for the benefit of the public. In the USA it came to mean a school run by government. Since the services of government are ideally intended for the people, the term "public" came to mean the sector of the economy owned by government.

The "private sector" is the rest of the economy, the sector that is not run by the state. But for goods, the term "private" has a completely different meaning. "Private goods" are those individually used, like the food you eat, eaten by one person. Private goods such as passports can be provided by government. And public goods can be and are provided by the private sector.

It is clearer if we call public goods by the term "collective goods." Collective goods are non-rival, meaning the use by one person does not reduce the use by another. My presentation here is a collective good, since each of you is perceiving the entire presentation, and the presence of other people does not inherently reduce the perceptions of others. In contrast, private goods are rival, the use by one person inherently diminishes the potential or actual use by others.

We can also divide collective goods into those that are excludable, and the others that are non-excludable. "Excludable" means that it is physically possible to pre-

vent a person from using the good. Very few produced collective goods are excludable.

The police can exclude people from highways by stopping them and arresting them. Even national defense is excludable, since the service excludes foreigners, and persons can be deported from the territory.

Some economists define a public good as both non-rival and non-excludable. But the American economist Paul Samuelson in landmark articles in the 1950s defined public versus private goods mathematically by non-rivalry, and that is the definition that I believe is most apt. Excludable collective goods are also called "club goods," a club in economics being an organization that provides collective goods to its members.

So, "The Private Provision of Public Goods" means the provision of collective goods by the private sector.

## Private or Public Provision of Public Goods

Now, what is the difference between government and private enterprise? First, let me define the term "governance." "Governance" has two elements: First is rules. Second is the power to enforce the rules.

A government is governance imposed by force, without the explicit agreement of all the competent parties. A "state" is a government with territorial jurisdiction. In contrast, a club has voluntary governance.

Some scholars have claimed that there is no clear distinction between imposed and voluntary governance. They say that if one lives in a city or other governmental jurisdiction, one implicitly agrees to the rules; that this presumes an implicit contract. But in my analysis, agreement has to be real. A person needs to think and feel that he agrees. How can I agree if I don't agree that I agree?

Before one buys a unit in a homeowners' association, one is provided with the master deed and bylaws, and one signs the document explicitly agreeing with the rules. In contrast, when one moves into a governmental jurisdiction, there is no



written contract. In the USA, real estate contracts must be in writing. This documents a real agreement.

There are of course implicit agreements in the market. It is understood that when I enter a shop, I need to pay for the things I take out. The shopper knows this and, if he is not a thief, agrees with this. But if one just moves into a city, one knows there are laws that one has to obey, but there is no mental agreement with these laws. Moreover, there is no legally free entry into the government business, so one cannot start one's own government, in contrast to the ability to produce private communities.

Another difference is that government officials have sovereign immunity. In the countries established by Great Britain, the concept of sovereign immunity derives from early English law. The courts were the creation of the king, and under the king. Such was the case in other countries. In the United States, the federal government has sovereign immunity, as do the states, which are also sovereign governments.

Thus the sovereign or state was and is immune from civil suits or criminal prosecution. Governments may waive this immunity to allow for suits for specific wrongs, such as large holes in the streets that cause tire damage, but usually government chiefs may not be sued for the misperformance of their duties.

In contrast, with a private community, or communal self-governance, all the parties are legal equals, and may be sued for violating the mutual contract. Communal self-governance implies an explicit agreement or contract among legal equals.

## **Liberalism and the History of Communal Self-governance**

Before we examine the history of communal self-governance, I would like to say a few words about classical liberalism, about the ethical basis of liberalism. The pure free market is an economy in which all activity is voluntary for everyone. What does it mean for an act to be voluntary? Voluntariness implies an ethic whose rules tell us what acts are voluntary and which are not. For there to be a universal meaning to the concept of a market and of freedom, there has to be a universal ethic. Where would it come from?

It has to come from what is common to humanity, namely, human nature. John Locke in his *Second Treatise of Government* provided the premises: equality and independence.

In my first book *The Soul of Liberty*, I derive natural moral law, as expressed by the universal ethic, with five basic rules:

1. A benefit is an act welcomed by the recipient.
2. Acts that benefit others are morally good.
3. A harm is an invasion into another's domain.
4. All acts, and only those acts, that coercively harm others are evil.
5. All other acts are morally neutral.

A harm involves an invasion into another's domain. If an act is disagreeable merely because of the recipient's beliefs and values, then the act is an offense, not a harm, and the act is morally neutral. Free speech implies that one may say what one wishes even if others do not like what the speaker says.

A society has liberty when law implements the universal ethic and only that ethic. That is the moral basis of classical liberalism. The right to do something means that the negation of that act is wrong. So natural rights are a function of the universal ethic. We have a natural right to do anything that does not coercively harm others.

Now to the history of thought on communal liberalism. This history goes back at least to Thomas Spence in the UK. He wrote of assembling landed property and letting it out on leaseholds. His paper was delivered to the Newcastle Philosophical Society in 1775. It was originally titled 'Property in Land, Every One's Right'. It was republished as a pamphlet, *The Real Rights of Man*.

Ebenezer Howard developed a theory of civic associations in his book, *Garden Cities of Tomorrow*, published in 1902. The basic idea was a "voluntary plan of public finance" using leaseholds of land. Howard envisioned combining the qualities of city and country environments. He wrote, "Human society and the beauty of nature are meant to be enjoyed together [...]. Town and country must be married."

A pioneer of the theory of the proprietary community, a privately owned community with a single individual or corporate owner, was Spencer Heath. He assembled a collection of his papers in 1936 called *Politics versus Proprietorship*, subtitled "A Fragmentary Study of Social and Economic Phenomena with Particular Reference to the Public Administrative Functions Belonging to Proprietorship in Land - Proprietorship as a Creative Social Agency." Heath's main work was, *Citadel, Market and Altar*, published in 1957.

Heath's grandson, Spencer Heath MacCallum, continued this line of thought. In *The Art of Community*, published in 1970, MacCallum examines the proprietary community as a vehicle that resolves the public-goods problems, free riding and transfer seeking, as proprietary communities integrate governance and markets. I see myself as furthering the thought of both MacCallum and Howard.

The book *The Voluntary City* collected these various streams of thought into one volume in 2002. There are now many scholars who are writing about contractual governance. These include Spencer MacCallum, myself, Evan McKenzie, David Beito, Robert Nelson, Chris Webster, and Georg Glasze.

## To the History of Communal Liberalism

There are two principle categories of communal self-governance: First, the proprietary community, with a single owner, the users being tenants. Examples include hotels, shopping centers, office buildings, landlord-owned apartment buildings, marinas, ships, land trusts, and industrial parks or estates.

The second type is civic associations, with a contract among several co-owners. Civic associations include cooperatives, condominiums (meaning joint rule), and homeowner or residential associations.

A "residential community association" is a club that provides collective goods for a membership of residents in some geographical neighborhood. These are also called "homeowner associations." They are governed by real estate contract law and by their internal private rules, what is called the CC&Rs, conditions, covenants, and restrictions. A covenant is a type of contract in which the covenantor makes a promise to a covenantee to do or not do some action. In real property law, the

term real covenant is used for conditions tied to the use of land. Covenants can "run with the land", meaning that a new owner is bound by the covenant.

We can trace self-government to medieval Europe, where lords of the land organized free communities. The inhabitants received protection and services in exchange for the payment of rent. Each member of a "sworn commune" took a public oath to obey the city charter, agreements which are the root of the covenants of modern times. The charters of some medieval towns established liberties and self governance. The city charter was a social contract, and such contracts were historical sources of the contract theory of government.

The American anarchist Lysander Spooner described the Anglo-Saxon system as that in which "the state rested for support on the land, and not upon taxation levied upon the people personally." Freeholders held their lands on the condition of paying rents, and with military service.

The earliest known deed-related associations took place in the mid 1700s in London. Lord Leicester established a park in Leicester Square, and adjacent property owners agreed to an assessment to fund it, which benefitted them by increasing their property values.

Another self-governing community in Great Britain was Victoria Park, near Manchester, which was laid out in 1837 and operated privately until 1954. The sale of its lots carried with it "certain conditions, the 'laws' of the Park, which would protect its amenities." Victoria Park also levied tolls on some of its roads. St. Louis in Missouri has had an extensive system of privately owned residential streets since the mid 1800s.

According to Spencer MacCallum, the modern hotel, with its services, is an American invention. The word "hotel" is a French term meaning large house or town hall, and one of the first uses of the term in the United States was the City Hotel in New York, built in 1794, the first inn to be financed by a stock company.

The Tremont House in Boston, completed in 1829, was the first to provide what we today think of as "hotel service", beyond a place to spend the night. It became a model copied in many American towns. In the frontier, the public hall of the inn was often the only place to entertain and became the center of community life, as seen in many movies of the old American West.

The trend now is to combine hotel accommodation with office space and shopping facilities, aiming at a complementary use of space. In his book *The Art of Community*, Spencer MacCallum observes that "an empirical art of community has developed within Western society since mid-century [...] in the real-estate field [...]. In the United States and Canada there has been a major development since World War II of a distinctive form of association based on the organized ownership and unified administration of land."

These have been evolving to include complementary land uses, such as occurs in shopping centers with many different enterprises besides retail stores. Such clusters have on a smaller scale all of the functional requirements of municipalities.

In 1900, Arden Village was established in Delaware by followers of the American economist Henry George, as a land trust that collects rent from leaseholds. In the USA, land trusts date back at least to 1891, when the Trustees of Reservations was established in Boston by nature preservationists.

Edward Bouton of Baltimore is credited with the first shopping center in 1907. In the US there were only about 100 before 1950. The automobile made it feasible to have a community of shops offset from the street, with parking.

Industrial estates and parks began at the end of the 19th century and have a history of growth similar to that of shopping centers. An industrial park consists of a subdivision of land used by a community of industries, whereas an industrial estate – the preferred pattern in Great Britain – is a tract of land leased to industries according to some overall plan. With the estate leasehold system, the owner has both the incentive and the power to enforce rules or covenants, as well as the ability to modify any covenants that prove to be burdensome as the needs of the estate changes.

The mobile home park was the first substantial use of ground lease for single-family homes. It was also the first successful use of factory-constructed homes. Trailer parks developed from automobile campgrounds. The mobile home park evolved from trailer parks after World War II. Mobile home parks have been restricted by zoning ordinances.

The most famous private community opened in 1971, Walt Disney World, in Florida. The company assembled the land voluntarily, without using eminent domain.

# The Future of Communal Liberalism

In proprietary communities, there is a trend towards a larger size of projects and more varied land uses. This requires a more comprehensive planning and greater control and coordination in their operation by the owner. So this is a trend towards greater private governance.

The commercial real estate industry is being transformed from just selling sites and buildings towards a long-term ownership and management. Real estate developers have come to realize that the environment surrounding a site is important to the future vitality of the community. They also realize that a neighborhood can deteriorate after the sites are sold off unless there is some provision for the continuing coordination of land uses.

As we know, the expected future status of a neighborhood is reflected in its present site value. Real estate is developing into an industry whose product is the creation and maintenance of an optimal human environment. The profit-maximizing objective is to optimize the total environment of each site within a system of sites in order to maximize the combined rentals they will yield.

As islands of profitable proprietary administration grow in number and size, they will tend to federate their interests to provide collective goods over a greater area. A confederation of private communities could replace much of imposed government. Instead of reforming government, we can replace it with contractual self-governance.

The Community Associations Institute was established in 1973 by the Urban Land Institute and the National Association of Homebuilders to serve condominiums, co-operatives, and homeowner associations. Homeowners' associations are expanding rapidly world-wide. The conferences of the Research network on private urban governance have had papers on contractual self-governance in Europe, North and South America, South Africa, and Asia.

In China, many of the new housing developments are large private communities, often with populations of several hundred thousand, which provide public goods beyond those provided by government. The greatest growth of communal self-governance and privatization is taking place in China.

In places such as Russia and South Africa upper and middle income residents are forming gated communities to provide themselves with protection from crime, after government has failed to protect them. With its extremely high crime, many homeowners in South Africa have built walls around their houses, and they have turned their blocks into gated communities.

This turns the conventional theory of public goods on its head. Rather than government providing public goods in response to market failure, it is the market providing collective goods in response to government failure. So the future of communal liberalism depends in part on the future of government. As governments become more dysfunctional, private communities become more useful.

But also, as people become wealthier, they seek more collective services, and are willing to pay for them. So, greater wealth and less effective government will drive a greater demand for contractual governance and collective goods.

Finally, better technology reduces the rationale for governmental provision and intervention. The book *The Half Life of Policy Rationales*, co-edited by Daniel Klein and myself, argues that advancing technology reduces the rationale or justification for government provision of collective goods and intervention into enterprise.

Better technology increases economic complexity, which makes central planning more difficult. Complexity complicates what it is the regulator seeks to know. An example is the increased complexity of rapidly evolving financial derivatives. As Hayek said, knowledge is decentralized, ever changing and not able to be collected by a central planner.

Advancing technology also reduces natural monopolies, by reducing the scale of products such as electricity. It creates better boundaries such as electronic fencing for fish farming in the ocean. And better technology such as the Internet makes information cheaper. By reducing the intellectual case for government intervention, which is weak or non-existent to begin with, advancing technology favors the free market, including communal self-governance.

The free market enables us to better coordinate, innovate, and liberate, and that applies just as well to communal self-governance.









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