

The Economics of Private Defense

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Military defense is the classic epitome of a public good: seemingly both non-rivalrous and non-excludable in consumption. This is the opinion of the vast majority of economists and most common as well. This characterization goes all the way back to Paul Samuelson's work. (Sandmo A. 2008) It also carries on into the present day. In a paper entitled *Economists Have No Defense: A Critical Review of National Defense in Economics Textbooks* George Mason University economists Christopher Coyne and David Lucas survey 50 undergraduate textbooks on principles of economics, intermediate microeconomics and public finance. Among a variety of impressive results, they find that most relevant textbooks portrayed military defense as a public good and do not mention criticisms of public goods theory as applied to military defense. A textbook I have used in the past had this to say about the issue: "The combination of the nonrival and nonexclusion characteristics creates more severe problems for market provision, and in this case, a more active role for government may be required. No one has determined, for example, how national defense could be provided by private markets." (Coyne and Lucas, 2016)

It is important to note that public and private goods should not be thought of in such an absolute sense, but rather almost any public good can be rivalrous in consumption in specific institutional frameworks: a missile defense shield can only cover so much territory, and the firing of one missile makes fewer missiles available to protect others. Likewise, roads are typically considered non-rivalrous in consumption; however, if some drivers drive very slowly or too recklessly, then their consumption can easily be rivalrous concerning other users of the road.

Additionally, excluding consumers from using any given good is always possible, just not always cost-efficient. (Cowen 1985) It is indeed possible that many people do not want the amount or type of national defense that their state is providing. A supposed public good like national defense can quickly become a public bad. An excellent example of this is the internment of Japanese-Americans during World War II. Undoubtedly their utility was not improved by being forced into camps.

When doing institutional analysis, it is essential to keep in mind that there will never be any institutional arrangement that will be problem-free. The task of economic analysis is to help us find the trade-offs between different types of human organization. (Sowell 2008, 130) Any constrained vision of the world must account for the universal scarcity of the human experience, and the flawed nature of humanity. Every action has an opportunity cost. The question is not what intuitional framework provides the perfect or theoretically flawless solution, but rather which has the fewest problems, i.e., which set of institutions has the best set of tradeoffs. Which is more likely? State failure or market failure? Which set of institutions has better incentives?

This is the context of my thesis: I think that private markets and voluntary associations can provide defense services for lower cost and better quality than the state currently does.

For this thought experiment I am assuming the following.:

1. The society in question is a stateless one.
2. There are means for the enforcement of contracts.

In any theoretical economic paper, we must start with some set of assumptions about what the counterfactual society in question is like. Think of this paper as a thought experiment, if these assumptions are correct, does my argument make sense. In other words, consider the contingent plausibility of my arguments. It is important to differentiate what exactly would be different in this society:

1. There would be no institution with a monopoly over the use of force in a given geographical area. (This is the definition of a state)
2. This means there would be no taxes and thus no tax-funded military.

I am approaching this question with an Austrian economic framework. In order to properly ground my analysis, I will explain several principles that form the foundation for the study of economics from an Austrian perspective.

Man is a being endowed with rationality who uses means according to ideas to achieve ends. Society is nothing more than a conglomeration of individual humans organizing in the form of peaceful cooperation. Why is there peaceful cooperation rather than perpetual conflict? The fountainhead of the Austrian of economics, Ludwig von Mises explained widespread societal peace thus: “work performed under the division of labor is more productive than isolated work, and that man’s reason is capable of recognizing this truth. However, for these facts, men would forever remained deadly foes of one another, irreconcilable rivals in their endeavors to secure a portion of the scarce supply of means of sustenance provided by nature.” (Mises 1998, 144)

Thus, it is this sense of mutuality of benefits that induces men to cooperate in society peacefully. Society is not some master intelligence that directs the commoners, but rather is merely the name we give for when men come together for mutual benefit. To back up, the very nature of reality is one of scarcity. Scarcity means that there are never enough economic goods to satiate the desires of everyone completely. If humans could not cooperate in mutually beneficial ways, there would be a strong incentive to engage in constant combat for those scarce resources, because anything that one man consumes is less for others.

The mechanism by which men cooperate in society is the division of labor through voluntary exchange. This means that people can specialize at producing particular goods and services and then trade them for to others who are also specializing. Everyone connected in the division of labor can produce where she is relatively more productive compared to others. The more widespread and developed the division of labor is, the wealthy and more productive the society will be. This dramatically increases the productivity of labor because it allows people to not only become more skilled at what they specialize in through years of practice, but it enables the computer engineer to focus on creating computers, and it enables bakers to devote their energies to making bread.

What standard is used to evaluate how productive something is? Economics is a value-free science, meaning if someone is choosing one action over another, say exchanging money for apples, that means she is demonstrating her preference for the specific number of apples over the specific amount of money. Thus, we say that she is better off according to her subjective preference after she makes the transaction in

question. Since people voluntarily demonstrated their subjective preferences to acquire what they have, it makes sense that they want to keep it and not lose it, thus a universal incentive to protect private property. This is the thrust of human action.

When it comes to businesses, they measure the combined demonstrated preferences of their customers by calculating profit and loss. In order to do this, they need market prices which come about as a result of voluntary exchange. Likewise, in society, when people cooperate, their demonstrated preferences show that they value the goods and services that they get in voluntary exchange. Armed conflict decimates this process. “The market economy involves peaceful cooperation. It bursts asunder when the citizens turn into warriors and, instead of exchanging commodities and services, fight one another... in the long run war and the preservation of the market economy are incompatible. Capitalism is essentially a scheme for peaceful nations.” (Mises 1998, 817)

The state does not operate based on the demonstrated preference of people who choose to buy goods and services, but rather it is based on coercion: taking resources from people by force. This does not allow the state to use market signals to measure profit and loss, but rather the decisions of the state officials become mere arbitrary dictates. Arbitrary in the sense that they are disconnected from the actual desires of the people whose interests they supposedly represent.

When it comes to providing national defense or any other good, the state allocates resources very differently from how a business does so. Because they are not trying to convince their customers to purchase their products voluntarily, they do not have an incentive to improve quality or service. Additionally, when talking about providing a

good like military defense, the state prohibits competition. Competition is a powerful force for inducing innovation and efficiency. If people know that their actions might be rendered obsolete and their funds withdrawn, this realization will typically provide a powerful incentive to perform in the best possible way to keep that from happening.

This institutional framework and an accompanying incentive structure make armed conflict much less likely to happen in a market economy. The nature of market exchange is geared toward peaceful cooperation through voluntary transactions. Businessmen, in general, are harmed by conflict. War disrupts international trade which makes it difficult for businesses to sell and buy products from overseas. Additionally, war is very often accompanied by inflation, increased taxes, increased government regulation and what economist Robert Higgs calls “regime uncertainty.” (Higgs 2006, 1-36)

In summation, people have incentives to protect their property and to cooperate in a voluntary fashion. What follows is a rough sketch of ways people could apply these principles in defending their society without the state. I am not claiming that this is the way a voluntary society would sort out these issues, but rather these are some plausible ideas that make economic sense. These are possibilities of how entrepreneurs would act in certain types of situations. Because entrepreneurship is a dynamic force that is almost impossible to predict, we should not claim certain knowledge about exactly how it will operate in a counter-factual situation.

A common misconception about military defense is that it is necessarily homogenous nature in nature. However, it is important to remember that military defense is a complex system of processes that are not at all homogenous. They are particular: a

plane here, a tank there, a militia over there, there is a remarkable level of specificity. There is also a division of labor within the military. Private companies produce many of the weapons; there is a command, many divisions of rank, and funding from Congress. There is a great deal of diversity over a broad continuum of regions countries. People would have an incentive to protect property rights in varying degrees in varying geographical locals.

Given this, certain organizations would have more of an incentive to protect property rights in certain circumstances. Thus, shipping companies would probably provide hire or provide their fleet of battleships to guard their ships and ports. It is indeed plausible that they could use these ships to protect their proximate customers on the mainland, and, they could use their efforts to keep away pirates and deter aggression from potential aggressors to give themselves good publicity. (Murphy 2002, 46) Airlines could do the same thing: have a set of fighter jets that were available to protect them in a time of crisis. In our current economic system, companies compete with each for the goodwill of the public.

There are layers of stages when it comes to providing defense: the necessary provision of raw materials, converting them into tanks, guns, boots, airplanes and other armaments. Instead of having resources arbitrarily assigned by state agents, there would be price coordination and market competition throughout the whole process. If there is a soldier who is performing poorly, fire him and hire someone better. Many weapons manufactures would be competing for the business of various defense companies.

Additionally, the expanded division of labor would give many more people in the society resources to contribute to the defense effort.

All private property owners have an incentive to preserve their property, and a market division of labor induces them to hire security provision to protect it. It would be extremely cost prohibitive to have each individual property owner contract his security. It makes sense to use economies of scale to provide this good. So, it makes sense to have some sort of large group of people pay for it. The statist will immediately say that the wide-ranging scope of military defense is what makes it so well-suited for public provision. Indeed, some would probably argue that if voluntary individuals came together for providing military defense over a significant geographical area, there would be rampant free riding – individuals would realize that their contribution would not be the difference between the military defense being provided and it not being provided, so they would act in their self-interest and cease contributing financially. This is a fundamental challenge to the advocate of defense of military provision of private defense.

There are numerous possible answers to this issue. The first is that individuals and corporations would be aware of the risk of military attack and would take precautions, similarly to protecting themselves against other risks, by purchasing insurance. They would take out insurance policies on their properties to protect them financially against the threat of conquest. The insurance companies would then have the incentive to protect the property and would do hire private defense agencies to protect the property. Also, some free-riding is acceptable. As long as it can be theoretically demonstrated that there

are potentially enough overlapping ways to provide defense privately, some amount of free-riding will not kill a defense effort.

Big corporations would need to do something regarding defense, they cannot afford to, and some of the larger ones cannot overlook the impact that their decisions will have on national defense. (Murphy 2002, 49) If some people far away from the border do not buy defense insurance, that might not be the worst thing, but they also would probably get charged much lower premiums. Those near the border would get charged higher premiums, and there might be a situation where the private defense agencies could pull back to a more defensible position and ignore nonpayers. (Murphy 2002, 50)

A critic might object along the following lines: Isn't it plausible that the private defense agencies could form a cartel and use their specialization in force to keep out the competition, thus enabling them to charge higher prices and potentially oppress those whom they are supposed to be protecting? In other words, where is the guarantee of freedom of entry?

This is unwarranted - there would not be an eggs in one basket approach to military defense. The defense agencies would not be the only institution with weapons, nor would they most likely be the only institution that exercised military practice and training. There would probably be private militias, and the citizenry would have easy access to weapons.

Additionally, the insurance companies who would be paying the private defense agencies would withdraw payment immediately upon the slightest hint of aggression

against potential rival firms. The insurance companies would recognize that it was not in their self-interest to alienate their clients by patronizing businesses who threatened or extorted others. There would immediately be lawsuits, and hopefully retribution against any defense agencies or group that started to act like an aggressor. As stated previously the market economy is built on a foundation of private property, and if people in society try to impinge on this institutional framework, they are eroding the foundation of their society's prosperity.

Theft in this society would be frowned upon, punished and pushed to the very margins of society. The idea that a private company could somehow overcome all of these barriers and achieve a cartel via the use of force is highly improbable. It would be swimming upstream against all the institutions of this society to try to impose ruling by force on people. It is hard enough to use a state military to subjugate a people who do not want to be subjugated, as said elsewhere in this paper, guerrilla warfare is a potent force for resisting subjugation, and if large state militaries have a tough time doing it, wouldn't defense agencies find it even more difficult?

Perhaps most fundamentally, the vast majority of the people living in this stateless society would reject the idea of an institution with aggressive powers. The reason states exist is because most of the people that they rule form a social consensus which enables the state to rule. Even the most brutal and dictatorial regimes invest significant amounts of resources in trying to sway the public opinion via propaganda. As Dr. Hummel puts it: "All successful States are legitimized. No government rules for long through brute force alone, no matter how undemocratic. Enough of its subjects must accept its power as

necessary or desirable for its rule to be widely enforced and observed.” (Hummel 2001, 290) If enough of its citizens simply refused to follow dictates, the state would collapse overnight. Even within the state apparatus itself, the role of ideas is vital because here to legitimacy matters, if his subordinates refused to carry out his orders, even Kim Jong-un’s authority would be reduced to hot air.

If a state military attacked a private society, it would not be one state fighting one insurance company; the situation would be one state versus a whole group of insurance companies working together. These insurance companies would diversify, and most have a limit to how many policies they accept in a given area in order to avoid bankruptcy. (Murphy 2002, 47) They would also have access to international funding and not be limited by political borders. “The actual fighting may be occurring in Germany, but the funding could be coming from Canada and Cambodia. Distancing finance from the battlefield adds additional protection for a private society.” (Danneskjold 523)

In addition to insurance, a stateless society would be particularly well-suited to fight a guerrilla war. There are several reasons for this. First, there would not be any society wide-bans on firearms; thus there would be many more automatic rifles, grenade launchers, grenades, and many other deadly weapons. As in any guerrilla war, the populace would have several advantages over an invading force including exceptional knowledge of local terrain, the support of the native population (guerrilla operations are almost impossible without this) being able to blend in with the local non-combatants. (Hoppe 2003, 222-23)

Thus, all of these reasons increase the costs for an invading force to conquer and hold a stateless society. When this is combined with the idea that a stateless society would make a fantastic trading partner, you see that there both positive and negative reasons to avoid attacking a stateless society. The trading partner aspect makes it more profitable not to attack it, and the threat of guerrilla warfare makes the prospect of invasion much costlier.

In the case of conquest by a foreign government, a stateless society would not any of the state structures for the invader to uphold and create puppets to more effectively rule. This is a tactic that conquerors have found effective many times throughout history. The reasoning behind it is intuitive: subjecting a community to an invading army is associated with many costs, the foremost being violent resistance by the native people. However, the conquering state can use the local state to reduce costs of ruling such as cultural differences, language barriers, and any nationalistic feelings that may cause the natives to rebel at being ruled by a foreigner. Examples of this phenomenon include British control of India and the Spanish conquest of Mexico. (Hummel 2001, 528)

Some people postulate that having a big centralized military is far preferable to many decentralized units, and that may be the case in offensive warfare, but in defensive warfare, there is an advantage to having many smaller, more decentralized military units. There is no one master general to kill, no one command center to sabotage, and no one institution to surrender. Economist Murray Rothbard said it well when he explained: “Guerrilla warfare has proved to be an irresistible force precisely because it stems, not

from a dictatorial central government, but from the people themselves, fighting for their liberty and independence against a foreign State.” (Rothbard 2006, 299)

Additionally, it seems that a private society would be much more difficult to sabotage with espionage because there is no one institution to target. Additionally, there is no one institution to declare war on, and there is no one institution to take collective responsibility for crimes committed in foreign wars.

Historically, there are many examples of successful defensive guerrilla warfare. “All fighters are volunteers and all of their support: food, shelter, logistical help, etc. is voluntary. Hence, guerrillas must be extremely friendly to their own population. But precisely this: their entirely defensive character and near-unanimous support in public opinion can render them nearly invincible, even by numerically far superior invading armies. History provides numerous examples: Napoleon’s defeat in Spain, France’s defeat in Algeria, the U.S. defeat in Vietnam, Israel’s defeat in South Lebanon.” (Hoppe 2014)

Those who have read about abuses perpetrated under government-hired military contractors like Blackwater will probably balk at the suggestion of funding defense with for-profit soldiers. The dubious human-rights record of Blackwater is an issue here. Various states across the world typically hire the mercenaries. This gives them an entirely different incentive structure than purely private companies hired by private individuals. They often get hired to protect state officials, and they often have a state-like exemption from liability laws as they would operate for ordinary people. The nature of their clients

is also significantly different. The government can afford to pay out lots of money in lawsuits and often rules by brute force.

There is a potential objection here: if a large invading force attacks a stateless society, wouldn't there be a lack of coordination and united front because there would be many defense agencies?

This would not be an issue, because the defense agencies would have a common interest to work together to repel the invaders. To garner goodwill and reciprocity, and also because it is better to have stateless neighbors than statist ones. There is no distinct advantage to a centrally-planned defense. There is no need for any one person or institution to oversee the defense of a vast region because market incentives and coordination would take care of that.

I am assuming that a society with private defense would be a stateless society, it would seem that if the market could provide private defense, it could provide anything else. A stateless society would be a fantastic trading partner because its division of labor would be so expanded and sophisticated with none of the taxes, trade restrictions and wasteful expenses that the state burdens economies with now. Ludwig von Mises called the division of labor the "fundamental societal phenomenon" (Mises 1998, 157) it is one of the keys to a thriving society and is enable gains from comparative advantage in trade. No matter how little you produce, or how niche your output is, it is most likely that you will be able to find a way to be integrated into the division of labor, because of freedom of voluntary exchange. Because a stateless society would be such a great trading partner, all states that traded with it (which would be many) would have an incentive to protect it

and to establish defense alliances with to protect it against the aggressions of rival states. It is never in anyone's economic interest to have a trading partner conquered.

Are there current examples of the private provision of defense? There are examples of private individuals who use their own time and money to fight ISIS in the Middle East, as well as the fact that the US military uses private contractors all the time. (Rosenfeld 2015) This is not any stateless society ideal defense system, nor should we expect there to be because in almost everywhere around the world, the state monopolizes the provision of military protection. It is almost impossible to compete with a monopoly on the use of force that has all the big guns.

An additional factor, people often donate money above the market price even though they have nothing additional to gain from it. Customers give tips to taxi drivers even though most of us never expect to use the same taxi driver again, the same is true of restaurants in foreign countries. Many people (if not most) feel their conscience and social pressures urging them to pay slightly above the market price in order to financially benefit someone else. It is plausible to say that many people would donate to private defense agencies in the same way they tip to taxi cabs and the same way many citizens buy war bonds.

At first glance, it seems like the do or die nature of military conflict makes it far less amenable to the transactional, trial and error method of economic calculation in the free market. This is true to some degree, but it certainly seems like defense firms would set up many branches in various locations so that if one of their branches was eliminated, they could learn, adjust and survive. (Murphy 2002, 57-58)

Intuitively, it seems that the government by not having to listen to individual subjective preferences could spend a much more significant amount of money on research and development (R&D) than its private counterparts could. Government R&D is bloated and inefficient because the various military contracting businesses only need to service one big consumer who is not price sensitive at all. Private defense agencies would provide competition which would lower the price and improve the quality of armaments produced. Over time, the subpar firms would be gradually weeded out, and the R&D of private corporations would be different – the production structure would be geared more towards defense. The profit incentive would induce businesses to provide the best armaments for defense at the lowest possible cost.

There are many innovative options here. Insurance companies and defense agencies could estimate the gains from eliminating enemy targets. They could offer moderate amounts of money for enemy infantry, large amounts for disabling tanks and helicopters, and extravagant sums for killing a principal general. Thus, it is very likely that the efficiency benefits of market price coordination would apply to the war effort. (Murphy 2002 55) Private communities or societies could easily use the diplomacy and other factors that states use to prevent war from occurring. They could make alliances, trade information and work together.

The free-rider problem essentially says that people will free ride off the massive positive externality that defense services would provide. However, it is not certain that this is true, revolutions are an example of overcoming this difficulty and passing down

massive positive externalities to many people for hundreds of years later. (Hummel 2001, 530)

Much of this debate about comparative institutional analysis can be answered by comparing the system we have now, with a theoretical private system. Currently, states use alliances to help defend themselves against other states. Costa Rica is an excellent example of this, the country has not had any military since 1948, and they celebrate an end of the military day as a national holiday. They rely on other countries like the United States to protect them. It is indeed conceivable that a stateless society could have many such alliances and use them to protect itself in addition to insurance and everything else. Having an army can have massive and dangerous negative externalities like overthrowing the domestic government and instituting a police state. Costa Rica is protected by other countries like the United States, and it is likely that the trading partners of the stateless society could do the same thing.

Costa Rica has a significantly above average trade freedom. This is somewhat analogous to how a stateless society would operate: trade with all countries who want it. This gives other countries the incentive to protect their trading partners. If the US exports products to Costa Rica and Americans own property there, this gives the government a substantial tax incentive to protect the financial interests of those who pay taxes.

Anytime we are debating empirical examples, it is important to note that we will never get a perfect one. People will always be able to point out difficulties and differences that make it harder to use empirical examples. (this is why *ceteris paribus* qualifications are so essential in economics) However, when talking about specific ways

that the market can possibly overcome externalities, empirical examples can be somewhat helpful.

In his paper *Crowdfunding Defense*, Ph.D. candidate at George Mason University, Garrett Wood discusses how in recent years, private entrepreneurs and soldiers have filled in the gap that the government of Ukraine has left with military defense in the conflict with the pro-Russian separatists. A valuable insight that he expounds is that crowdfunding defense can signal to any foreign invader that the domestic population is more likely to be willing to fight an insurgent/guerilla war. Wealthy individuals like business owners may still donate to defense operations even if they know that people are going to free ride off their contributions. A specific example: “One billionaire, Igor Kolomoisky, spent ten million dollars a month funding a personal army of two thousand active fighters (with another twenty thousand fighters in reserve) to help secure the city of Dnipro (Hirst 2015).” (Wood 19)

Trying to argue that because the state hires mercenaries to do certain bad things makes mercenaries a bad idea, is a weak argument because it is the state involved, not purely private actors.

It is wealth, not the size of a country that enables it to defend against foreign aggression. (McMaken 2015) Studies have consistently shown that economic freedom is strongly correlated with wealth creation. (Hammond 2018) Thus there would be many assets worth protecting and a strong incentive to do so. Additionally, when discussing these issues in the context of insurance companies hiring defense agencies to protect their clients' property, it should be noted that the value of what is being protected will have a

substantial influence upon how much the clients are willing to pay, the premiums that the insurance corporations will charge, and how much money the insurance companies will be willing to pay to defend the assets. Private defense agencies could advertise how great they are and advertise any weaknesses in their rivals. This would give all parties involved the incentive to be the very best at everything. (Murphy 2002, 55)

At this point, a statist might object that I have not considered the possibility that a state could have significantly larger numerical troop advantage because of the ability to draft soldiers, which the stateless society would not have.

We know that drafted troops would very likely have weak incentives to fight an aggressive war which we established this stateless society would be fighting. If they were passionate about the war effort, they would have signed up voluntarily and would not have needed to be forced to go to war. This means that an entrepreneurial defense agency or insurance company could easily discover their vulnerability to propaganda, bribes, desertion, or cowardice on the battlefield. It is now very commonly known that volunteer militaries are superior to drafted militaries. Indeed, now even many state officials believe this to be so, including a former deputy of defense. It is detrimental to the economy of the nation who uses it because it randomly chooses those whose labor is more highly valued elsewhere, i.e., those who have a higher opportunity cost.

Because this society would be incredibly wealthy, the cost of losing their assets in an invasion would be incredibly high. Thus the amount of money that people would be willing to expend to protect these assets would be tremendous.

A critic might object that if there is a sparsely populated area next to a potentially aggressive state, the insurance premiums might not be enough to cover the costs of defending against invasion. (Although it depends on the value of the property in question.) If this was the case, if the risk of invasion was high enough to be considered significant to the owners of the property in question, it seems like they would move to areas farther away from the danger which would imply the insurance premiums would be lower. In other words, poor people living in a sparsely populated area could sell their property to wealthy individuals who could afford the relatively expensive insurance defense premiums.

What I am proposing is indeed radical, the privatization of a public good as critical as military defense is no small matter. However, when the framework of human action and the accompanying incentives are paired with specific formulations of private defense institutional frameworks, the case becomes much stronger than initially thought. I hope that my reader understands that just because he takes issue with one of the ways I propose to provide military defense privately, that does not make the case invalid.

All the eggs are not in one basket, so to speak. The force of all the various methods of providing the not-so-public good of national defense, from insurance companies, defense agencies, donations, militias, guerrilla warfare, and diplomatic/trade agreements, the combined case is strong. This issue comes down to the fundamental aspects of economics: human action, the division of labor, incentives to protect private property, voluntary cooperation, and the will to be free. Markets and voluntary

associations are creative and entrepreneurial; if left free, they will take risks, learn from mistakes, adjust and move on.

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