Traditionally, the early societies whose natures shed light on the facts of state emergence have been studied by social scientists other than economists. In fact, the economic theory of markets provides a number of insights into the emergence of states.

Economists usually talk in terms of the market for any given product; other social scientists talk of society. The two concepts are related and similarly vague. A society is a group of interrelated individuals sharing some common attributes. Two of these may be, and usually are, a common language and territory. In equilibrium, a single well-defined product must always sell for only one price in any given market area. For our purposes, the essential feature of both concepts is that each sketches out a definable group of people, all in such close interrelationship with respect to some endogenous variable that it is meaningful to talk of them as a group when investigating that variable. In empirical applications, economists often talk about sub-markets; societies are similarly recognized to have component sub-societies. As this work is in some senses one in social science itself, we shall use the two concepts interchangeably. The market for the punishment and protection industries is the society. In some instances we may wish to define the market “narrowly” and in others to define it “broadly.” The world is filled with societies, that is, with distinct but often interrelated markets.
for the provision of punishment and protection, but in some senses we are increasingly justified in talking of a world market for order, and so on, in which various governments compete.

In small societies both punishment and collective protection are produced by nonspecialists such as victims of crime or their revenge-seeking family and friends, "town meetings" of citizens and/or by more specialized persons such as chiefs, leading citizens, headmen, and so forth. Sense of "duty" may motivate people to join vigilante groups. Outraged bystanders sometimes intervene to forestall or to punish crime; civilian armies rally to defend society. Observe that many of these are features of more modern, larger societies as well. It is their relative importance that has changed. In the earliest societies, no individuals devoted a large part of their working time to producing protection and collective punishment. There was no regularly or continuously functioning "full-time" institution controlling the production of collective protection and punishment and in this sense no state. 2

The absence of states in small societies, in this sense, is readily explained by economic theory. The division of labor is always limited by the extent of the market. Since the demand for punishment and collective protection is so limited in small societies, full-time specialization does not pay. As the population of a given territory grows, however, demand increases, allowing a fuller exploitation of economies resulting from a finer division of labor 3 and fuller use of material inputs that have "large" fixed capacities ("indivisibilities"). Eventually, one supposes society reaches a size at which the demand for punishment and collective protection is large enough to support a firm specializing in their production. 4 That this may precede other forms of nonagricultural specialization is suggested by Fallers' 5 report:

Throughout traditional Africa . . . full-time occupational specialization, in the sense of freedom from participation in subsistence production, is more commonly related to political tasks. Whereas full-time specialization in craft production or trade is relatively rare, the specialist in government is quite common.

The dynamic process by which such firms typically emerge is a complex mixture of force and voluntary agreement. The emergent firm, a natural monopoly at this point, is the state or government of the society. 6 Its owners are the "rulers." 7

As society grows, the demand for punishment and protection is expected to increase for many reasons. For one, taking the rate of crime as given, the total amount of resources devoted to punishment must increase as the size of a society increases, if only because with more people and a constant crime rate, there will be more crimes requiring punishment and there will be more things to protect. Moreover, ceteris paribus, increases in the size of society also increase