LAW AS A DISCOVERY PROCEDURE

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Introduction

The process by which disputes are resolved in courts of law has long been viewed as a type of discovery procedure. It has been argued, for example, that common law judges do not decide cases by imposing their will on litigants. Instead, they merely find ("discover") the rules of conduct that have applied in other, similar cases and situations. In so doing, it is argued that judges use the knowledge embedded in customs and precedents, knowledge that is dispersed among millions of people and tested by centuries of experience.[1]

In recent years another social process that has attained status as a discovery procedure is the process of economic competition in free markets. This view developed from a lecture given by F. A. Hayek at the 1968 meetings of the Philadelphia Society.[2] In that lecture, the future Nobel laureate said:

> I propose to consider competition as a procedure for the discovery of such facts as, without resort to it, would not be known to anyone, or at least would not be utilized.
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> This may at first appear so obvious and incontestable as hardly to deserve attention. Yet, some interesting consequences that are not so obvious immediately follow [Hayek 1978, pp. 179–80].

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[1]See, for example, Leoni (1972).

[2]"Competition as a Discovery Procedure," Chicago, 29 March 1968. Published in Hayek (1978). For a more recent discussion of competition as a discovery procedure, see Kirzner (1985).

This paper will attempt to unify the respective notions of a discovery procedure that are present in the study of law and economics. The second section of this paper will briefly review the relevant parts of Hayek's argument and clarify what is meant by an "effective" discovery procedure. The third section will explain why the common law process is not, in fact, a procedure that is systematically effective in discovering legal rules. Government legislative processes are seen to be ineffective for the same reason. The third section will then outline a private legal process that, arguably, offers more promise.

The fourth and fifth sections will discuss some criticisms of a private legal process, emphasizing those made by William Landes and Richard Posner. The sixth section will argue that, even if it were ultimately found to be defective, the mere outlining of such a process yields "some interesting consequences that are not so obvious" for traditional issues in legal philosophy. The issues will include questions in tort and contract law, the proper relationship between law and morality, and whether law and morality are properly seen as essentially utilitarian devices or as manifestations of *rights* to be honored independent of utilitarian considerations.

Competition as a Discovery Procedure: A Recapitulation

Hayek's 1968 lecture grew out of a 1945 paper (Hayek 1945) and a lecture given at the London Economic Club in 1936.[3] Early on, Hayek made the simple point that knowledge in society is not located all in one place (e.g., in the central government) and never can be. In his 1945 article he argued that this is especially so in light of the fact that most knowledge does not exist in the form of a conscious awareness of the rules governing natural and social phenomena—"scientific" knowledge. Rather, most knowledge consists of an informal or tacit awareness of "circumstances of time and place"—knowledge of the likes and dislikes of particular people, trends in the flow of traffic, intricacies of various jobs, conditions in different neighborhoods, and so on. Such knowledge of heterogeneous conditions and preferences cannot be communicated in any practical way to a central planner (who would then issue directives to enterprises). The people who have this knowledge are often not even conscious of the fact that they have it, and a planner who did not have this knowledge in the first place would not even know all the questions to ask to get it. Decentralized markets, on the other hand, make spontaneous and

[3]"Economics and Knowledge," 10 November 1936. Published in Hayek (1937).

economical use of this informal knowledge as individuals pursue their various interests. Without individuals even being aware of the process, prices spread information about the availability of resources and coordinate people's actions.

In his 1968 lecture Hayek elaborated on this theme by pointing out how the profit incentives of the competitive market process provide a means of mobilizing and transmitting knowledge, which is dispersed throughout society. At the same time, losses provide negative feedback that helps to root out errors and contradictions in people's beliefs. It should be clear from a close reading of the quotation at the beginning of this paper that Hayek's lecture went beyond describing a process whereby people use preexisting knowledge. He was also speaking of a process whereby new knowledge is uncovered. At a later date, Hayek (1979, p. 190) expressed this point by saying that a person "will discover what he knows or can find out only when faced with a problem where this will help."[4]

Thus, people acting within a competitive process can progressively discover what wants are worth satisfying. Economical ways of satisfying these wants, including appropriate organizational forms for enterprises, can be discovered as well.

As Hayek commented at the end of his 1968 lecture, however, an effective competitive process requires a complementary legal environment that defines and enforces rights concerning property and contracts. But Hayek's 1968 lecture did not go far in outlining the features of such a legal environment except to say that appropriate "protection for private initiatives and enterprise can only ever be achieved through the institution of private property and the whole aggregate of libertarian institutions of law" (Hayek 1978, p. 190).

The Legal Foundations for Effective Discovery Procedures

Elsewhere, of course, Hayek has expounded at great length about the importance of an appropriate legal framework. His writings are full of admiration for the common law process as a generally effective mechanism for the discovery of legal rules.[5] He has also been critical of this process in certain respects and has looked to legislation as a corrective device (Hayek 1973, pp. 88–89). But neither Hayek's praise nor his limited criticism of the common law process takes full account of the modern literature on the economics of property rights

[4]Quoted in Kirzner (1987, p. 13).

[5]See especially Hayek (1960, 1973).

and other research in law and economics. As we shall see, this work makes clear why the common law process sometimes goes awry; it has started to articulate the precise conditions under which the process will, or will not, be effective. It also suggests why government legislative bodies cannot be counted on as a corrective device and points to radically different legal institutions as a possible means of at least shedding light on the principles on which many legal issues might be resolved.

The Concept of an Effective Discovery Procedure

First, the concept of an "effective" discovery procedure must be clarified. It might be asked, for example, how this notion differs from the concept of economic efficiency typically used in neoclassical economics. The two concepts are indeed related, but neoclassical economic efficiency (as conventionally discussed) refers to a hypothetical situation of equilibrium in which all gains from trade (including "trades" with nature such as investments in labor-saving devices) have been exhausted. It implies that the process that presumably brought this state of affairs into existence has done its work and has (momentarily) ceased to operate. The notion of an effective discovery procedure, on the other hand, refers to an ongoing process whereby information about not-yet-exhausted gains from trade is continually and economically uncovered and disseminated to individuals. It refers to the learning that takes place under perpetual disequilibrium rather than a general equilibrium in which all learning has stopped.

Standard neoclassical models can claim to take into account dynamic considerations by discounting the future benefits and costs of various actions through some interest rate. But it is also the case that, because these models focus on end-states (equilibria) rather than an ongoing process, they tend to engender a static outlook. Such an outlook can mislead an individual when forming normative judgments about social processes because, although a particular process might be performing better than any alternative could, a snapshot of the conditions prevailing at any particular moment (e.g., prices not equal to marginal costs, uninternalized external benefits) might lead one to conclude that the process was not working effectively.

Moreover, standard neoclassical models abstract from transactions costs—the costs of seeking out, negotiating, and enforcing agreeable terms of trade among individuals. Incredibly, many evaluations of social institutions still implicitly compare the way in which they allocate resources in the presence of transactions costs with a situation in which transaction costs are assumed not to exist. Not surpris-

ingly, the institutions in question will then be deemed to be flawed in some way (Demsetz 1969).

In fact, under complementary legal institutions, the process of competition in free markets discovers ways to reduce transactions costs as well as other costs (e.g., production costs). In a world of scarce resources, on the other hand, it is usually not worthwhile to drive costs down to zero, and it is the existence of positive transactions costs that lies behind what standard neoclassical analysis refers to as market failures—the existence of monopoly power, uninternalized externalities, and public goods (Dahlman 1979). So unless there is an alternative process that is *systematically* better at economizing on transactions costs, "market failures" are not worth eliminating.[6]

To summarize, if we say that one social process constitutes a more effective discovery procedure than another, we mean that it constitutes a systematically more economical way of generating and transmitting information about not-yet-exhausted gains from trade (as these are subjectively valued by individuals), including information about those gains that are or are not attainable after considering transactions costs. One might, therefore, say that an effective discovery procedure is Austrian economics' disequilibrium counterpart to a neoclassical concept of an efficient equilibrium in which the presence of information and transactions costs has been fully accounted for.

Property Rights and Effective Discovery Procedures

It cannot be said that a majority of the economics profession, let alone the legal profession, has really grasped the nature and implications of the property rights structure that underlies a systematically effective discovery procedure. It has by now been established that any institution, whether private or public, will systematically fail (in a standard neoclassical sense) unless it is governed by a property rights structure that is complete (i.e., a structure wherein rights are defined, enforced, and transferable). What must be more plainly said is that government institutions, by definition, involve property rights that are not freely transferable. If they were freely transferable, they would be private property. At the same time, it must be pointed out that defining, enforcing, or transferring property rights is sometimes very costly, so that it may not always be worthwhile for these activities to be carried out to the full extent abstractly possible.

So, in a sense, the law and economics literature has painted itself into a corner. That is, institutional failure is seen as avoidable—

[6]Technically speaking, they would be Pareto-irrelevant.

if appropriate property rights structures can be established. The establishment of appropriate property rights structures is, in turn, seen as a basic function of government. But government itself is governed by a property rights structure that the literature would deem inappropriate, so how can it be expected to carry out its tasks successfully? Modern legislatures in particular have been thoroughly critiqued in the literature on public choice.[7] In their defense, one can only try to argue that alternative institutions are worse.[8]

On a more optimistic note, some writers have viewed the system of common law that has grown up in the Anglo-Saxon world as the product of a procedure that generally promotes economic efficiency. Richard Posner has, of course, been this view's most vigorous proponent (Posner 1986, Part II).

In a review of the now-voluminous literature on the alleged efficiency of the common law, Peter Aranson counted 5,971,968 possible combinations of assumptions about conditions under which the legal process operates (Aranson 1986a). Many, perhaps most, of these combinations are consistent with neoclassical economic efficiency, but many are not.[9] Still others remain to be analyzed.

Insofar as the common law process is defective, Hayek (1973, p. 89) has attributed its shortcomings primarily to the (upper) class interests of judges: "the development of the law has lain in the hands of members of a particular class whose traditional views made them regard as just what could not meet the more general requirements of justice."[10] Hayek provides some other possible explanations for the common law process being defective, but none of them gets to the fundamental issue: the property rights structure governing the process. It is not necessarily undesirable if upper-class individuals provide people with clothes or hotel accommodations. The discovery procedure of the market on some occasions overtly selects such individuals to be suppliers. Should the provision of legal dispute-resolution and rule-making services be different? Perhaps so, but there is no real way to know without an effective discovery procedure. And an effective discovery procedure requires an appropriate property rights structure. Even if upper-class people tended to emerge as judges under such a structure, they would not necessarily act in

[7]See, for example, Kramer (1972); Gibbard (1973); Satterthwaite (1975); McKelvey and Niemi (1978); and Denzau, Riker, and Shepsle (1985).

[8]For additional discussion as to why governments establish property rights structures that are neoclassically inefficient, see North (1981, chap. 3).

[9]For some examples of tort rules that are not efficient, see Rizzo (1979).

[10]See Posner (1986, pp. 233–38) for a discussion of some common law rules that might appear to have been distorted by class bias, but are actually efficient.

the same way as in a common law process, because the system of incentives would be different. So again, the class interests of judges, or even their personal ideologies, are not the main issue. The property rights structure is. Insofar as common law judges are decision-makers of enterprises—government courts—for which rights are not transferable, and sometimes not even defined, they are in the position of central economic planners.[11] They cannot know all the circumstances of time and place that would be relevant to efficient decisions, and there is no discovery procedure to duplicate that which prevails in free markets.[12]

An Alternative

We now proceed to outline a legal system that is governed by a property rights structure which would appear to be more complete than that of the common law (or of government legislatures).[13] It can be argued, however, that in some respects the property rights structure governing this alternative is still not complete. Two points should be made about this qualification at the outset.

First, as mentioned earlier, because it is costly to define, enforce, and transfer property rights, it may not always be worthwhile to articulate a complete set of rights; the resources that would be employed to do this have alternative uses. It is, therefore, likely that at any point there would still exist some "commons" areas.

Second, to the extent that incomplete property rights manifest themselves in the form of externalities and to the extent that, inclusive of transactions costs considerations, there are net benefits to be had by internalizing them, then there will be opportunities for the evolution of institutions to do so—provided that there are no legal barriers to the operation of market forces.[14] This simple point tends

[11]For related discussions of this point, but with less of an emphasis on property rights, see Epstein (1980), Rizzo (1980a), O'Driscoll (1980), Rizzo (1980b), Epstein (1982), Rizzo (1985), and Aranson (1986b).

[12]It should be noted that insofar as the articulation of legal rights affects people's wealth, the pattern of demands for goods and services, and relative prices, the neoclassical concept of efficiency is, in this context, somewhat ambiguous. This is not to say, however, that the concept is empty or "a mirage." But see Rizzo (1980b).

[13]Though differing in detail, this model was inspired by the model put forth in Rothbard (1970, chap. 1).

[14]Of course, genuine "prisoner dilemma" situations do exist wherein, from an individual standpoint, the incentives to cooperate with others to internalize benefits are ambiguous. The question then is simply this: Given that such dilemmas exist in a world of transactions costs, what institutions work best? Are they monopolies over the use of coercion and that operate under incomplete property rights? Perhaps. But for a discussion of how cooperative behavior may turn out to be a dominant strategy in prisoner-dilemma situations under *noncoercive* institutions, see Axelrod (1984).

to be lost when markets are analyzed in terms of (static) equilibrium states instead of being viewed as part of an ongoing (dynamic) process of discovery.

To say that the property rights structure governing the resolution of legal disputes is complete, or nearly complete, would be, of course, to say that the legal system had been privatized. It is not difficult to see how a private system would operate in cases where the parties to a dispute agree to be bound by the decision of a particular arbitrator. But in cases where the parties do not have such an agreement or, more dramatically, where certain people (e.g., criminals) brazenly refuse to be bound by any judge or any law whatsoever, it is less clear how a private legal system would function. And if everyone's assets were subject to the whims of gangs or private armies, the property rights structure would, of course, be very far from complete.

The model for such a system is as follows: If X accuses Y of wrongful behavior, X may bring suit against Y in any private court willing to hear the case. If Y agrees to submit to the decision of the court, the ruling of that court settles the matter. But Y might refuse to submit to the decision of that court. He might instead turn to a court of his own choosing or to a private protection agency to defend his interests. At this point, there is the potential for violence between X and Y, or between their respective agents, just as there would be if Y refused to submit to the decision of a public court in today's world. Put simply, an individual would resort to violence if the expected benefits exceeded the expected costs. So if the stakes in the dispute were relatively high, and if the damages (to one's person, property, reputation, etc.) that one expected to result from a violent confrontation were relatively low, there might well be violence.[15]

The above conditions would undoubtedly exist on many occasions under a private legal system. They often exist in today's world. On the other hand, even if the technology of violence (fists, clubs, guns, bombs, etc.) in the possession of the parties were rather unequal, negotiation or submission to arbitration might be a preferred strategy. Even if one party could expect to "win" a violent confrontation, the costs of doing so might leave the net benefits to that party lower than they would have been under a peaceful strategy.[16]

[15]One argument in favor of having a powerful state is thus that the expected costs of fighting the state are so high that private parties will be deterred by and large from using violence. The question is then whether the state itself can be effectively constrained in using coercive power.

[16]A related issue is how the efficient scale of operation for private protection agencies would compare to that for criminal groups. Gordon Tullock, for example, fears that criminal groups would operate on such a scale that they would dominate society, but

One can, of course, find historical examples of both violence and negotiation or arbitration. One can also find various strategies based on bluffs. A priori, the quantity of violence in the model is indeterminate. What is relevant are the empirical studies of how the various facets of a private legal system operate in comparison to those of other legal processes (the common law, legislation, dictatorship, etc.). It is worth noting, for example, that in his study of the spontaneous emergence of private property rights in California's gold fields, John Umbeck (1981) found that there was actually relatively little violence in those fields during the gold rush of the late 1840s.[17] To cite another example, David Friedman (1979) has estimated that, at its worst, the average number of people killed or executed per year under medieval Iceland's private legal system was, on a per capita basis, about the same as the rate of murder and nonnegligent manslaughter in the United States in 1976.

It is asserted here that individuals acting under a private legal system would generally conclude that submitting to some peaceful means of resolving disputes is preferable to the use of violence. In the model discussed above, the respective agents of X and Y might negotiate a settlement or agree to submit to a private court's decision. In any event—including the possibility that Y would be forcibly brought to trial—if Y were ultimately found guilty of wrongdoing, he could try to appeal the case somewhere. If Y could not overturn the decision, however, he might be subject to some form of punishment, such as providing restitution to X.[18]

As various kinds of cases were resolved, a system of law would evolve. Over time, the resolution of new and different cases would produce an ever-more sophisticated set of rules to guide individual conduct. Just as no one can forecast the precise set of prices that will govern private market transactions during a particular period, no one can be sure of the precise rules that would govern the resolution of disputes in a private legal system during a particular period. Rules would emerge through a process of discovery. Ex post, moral and legal philosophers might be competent to discuss the general characteristics of the rules of conduct that emerged, just as some economists

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Anderson and Hill's (1979) study of the American West found little to support that view.

[17]Umbeck's title was meant only to point out that even a benign set of rights is often enforced by the threat of violence.

[18]There would naturally be cases over which more than one court granted jurisdiction. The courts involved might indeed follow conflicting rules as to how the case should be resolved. An entire body of law called "the conflict of laws" has arisen to deal with such situations, however, and this law evolved spontaneously. See Weintraub (1980).

are competent to discuss the general nature of factors that determine prices in free markets. No economist, however, is competent to deduce the whole set of market prices a priori, and no moral or legal philosopher would be competent to deduce the whole set of legal rules in advance. To try to do so would be to fall victim to an uncritical rationalist hubris. Following Hayek, spontaneous social processes, including spontaneous legal processes, use more information than any single person or group can ever possess.

Points of Controversy

Six major points of controversy will now be discussed with respect to a private legal system: (1) the incentives for private courts to provide impartial justice, (2) the incentives to articulate legal precedents, (3) the incentives for standardizing legal rules across jurisdictions, (4) the problems posed by instances of large numbers of small claims, (5) the private protection for legal rights that would emerge, and (6) the desirability of the social conventions that would underlie a private system of law. All of these points of controversy cast doubt on whether a private legal system would be governed by an effective legal discovery procedure.

With respect to the first point of controversy, Landes and Posner (1979, p. 254) have argued that competition among courts might not suffice to resolve disputes in an optimal manner insofar as it is the plaintiff who determines the choice among courts having concurrent jurisdiction over his claim. Thus, they argue, both the substantive and procedural rules that emerged would systematically favor plaintiffs at the expense of defendants, neoclassical efficiency, and, more intuitively, basic notions of fairness. In a similar fashion, it can be argued that the decisions reached by private judges would systematically favor wealthy litigants, who could afford to pay higher court fees than poorer clients.

With respect to the second point of controversy, Landes and Posner have noted that there is a difference between resolving disputes and articulating legal rules (i.e., precedents) to guide future decisionmaking. Even if private judges resolved disputes efficiently, it is argued that since the interests of future decisionmakers are not fully represented in present cases, a private legal system would underproduce precedents (Landes and Posner 1979, pp. 238–39). In other words, the articulation of precedents is viewed as having benefits that a free market would fail to internalize.

The third point of controversy—the incentives for standardizing legal rules across jurisdictions—is Hayek's main concern about a private system of justice.

> I believe there is one convincing argument why you can't leave even the law to voluntary evolution: the great society depends on your being able to expect that any stranger you encounter in a given territory will obey the same system of rules of law. Otherwise you would be confined to people whom you know. . . . So in a sense you have, at least for a given territory, a uniform law and that can only exist if it's enforced by government.[19]

According to this argument, a common system of law, like a common language or a common money, reduces transactions costs among strangers. The alleged market failure is that, although nearly everyone would benefit from a common legal system, private courts resolving disputes on a case-by-case basis would have incentives to cater to the more immediate, heterogeneous interests of their clients instead of to the public good of legal uniformity; privately produced law would be haphazard and would render behavior unpredictable.

With respect to the fourth point of controversy—instances of large numbers of small claims—the argument is that, unless the claims could be feasibly aggregated in the form of class-action suits, the litigation costs could be so enormous that even highly imperfect government legislation to govern the activity in question would be preferable to a system of courts.[20] Even if class-action suits were used, there could still be tremendous problems in allocating damage awards among all parties to the suit. In the case of air pollution caused by automobiles, for example, would the millions of people who are injured in some way have to try to divide up damage awards that they would collect from millions of drivers?

The fifth area of controversy—the operation of private protection agencies—revolves around two possible market failures. First, are there not external benefits that derive from an agency's patrolling an area? That is, if someone pays a security agency to deter criminal activity in a certain area, will that not benefit others who might not have paid the agency? And if an inability to collect from all beneficiaries encourages free-riding behavior, wouldn't that discourage an optimal amount of protection from being provided? Second is the argument that protection is a natural monopoly. Robert Nozick (1974, Part I) and also James Buchanan (1977, p. 52) have put forth this view. According to Buchanan:

[19]*Nobel Prize-Winning Economist: Friedrich A. von Hayek,* interview conducted by the Oral History Program, University of California–Los Angeles (1983, p. 348). See also Landes and Posner (1979, p. 239).

[20]Posner has pointed out that it is unclear whether indemnity offers any improvement in efficiency here. It may reduce legal errors but increase litigation costs. See Posner (1986, pp. 537–40).

> Conflicts may occur, and one agency will win. Persons who have previously been clients of losing agencies will desert and commence purchasing their protection from winning agencies. In this manner, a single protective agency or association will eventually come to dominate the market for policing services over a territory.

As previously discussed in this paper, there is thus a fear that conflicts would be resolved by violence instead of by developing legal rules. The argument now is not only that violence would be widespread, but that there would be large economies of scale in the use of force, and the agency that would be able to reap these economies would be in a position where "might makes right." In fact, if and when a single agency gained a dominant position with respect to the use of coercion, it would constitute an emerging state.[21]

The sixth and last point of controversy involves the formation of social conventions such as values and norms that underlie a system of law. There is a fear, which goes back at least as far as Aristotle, that if values and norms are left to spontaneous evolution, society is likely to become increasingly decadent; if left to their own devices, law and social order generally may break down over time. Once more, it is argued, a state is a necessary evil in the struggle to cope with some of the defects of extensive liberty.

Counterpoints

Private Courts to Dispense Impartial Justice

Let us look at each point of controversy in order. First is the issue as to whether private courts would dispense impartial justice. Landes and Posner (1979, p. 255) comment that during the centuries when English plaintiffs often had a choice among competing courts, there was "none (of which we are aware) of the blatant plaintiff favoritism that our economic analysis predicts would emerge in such a competitive setting." They also provide the proper explanation as to why history did not conform to their theory: Under competing courts, the defendant may be able to opt out of the forum preferred by the plaintiff (p. 254). There must then be a negotiated agreement or some other method of deciding on the court to which their dispute is submitted. Landes and Posner reject this explanation as a general answer to the problem of dispensing impartial justice in a private legal system, because they worry about cases wherein a defendant who fears the outcome of unbiased adjudication refuses to have his

[21]A state can be defined as an agency with a concentration of the privileged use of force. In a literal sense, the state does not have a monopoly.

dispute heard in an impartial setting. "This problem can be overcome only if the parties to a contract agree in advance to the submission of any dispute arising from the contract to a particular tribunal" (p. 254).

What Landes and Posner do not discuss are the range of possibilities for pressuring or even coercing recalcitrant parties who have not previously agreed to a particular tribunal. The threat of coercion is the ultimate weapon that a government has in the event that a party refuses to submit to a court's jurisdiction, and Landes and Posner do not object to government's having a (virtual) monopoly over coercion's legitimate uses. In England beginning in the 11th century, however, the Roman Catholic church used its much-feared power of excommunication in competition with the coercive power of secular authorities. Secular authorities could act on behalf of their courts with armed might, but those who sought refuge in the church's ecclesiastical courts could, in many cases, call on what the devout considered to be an even greater power.

To be sure, secular officials often used coercion arbitrarily, and church officials can be criticized for the manner in which the excommunicative power was sometimes used, but—after what was admittedly a long struggle—the most striking outcome of such confrontations was the emergence (discovery) of relatively uniform rules of law to resolve differences among competing court systems. These rules were independent of the will of any single (monopoly) authority. The issues governed by them included not only a variety of substantive disputes among individuals, but procedural disputes between church and king concerning court jurisdictions and recalcitrant parties (Berman 1983, chap. 7).[22]

The point here is thus that recalcitrants can indeed be pressured into appearances before (presumably) impartial adjudicators, even in the absence of contracts, under the protections of a rule of law that is the result of a competitive process. In addition to providing an answer to Landes and Posner's concerns about impartial justice for defendants, such a process provided the means by which individuals from historically oppressed classes started to gain a greater degree of autonomy during the Middle Ages.[23]

[22]Competing court systems also developed *within* the secular sphere. It should be noted that many decisions were enforced by a threat of ostracism rather than coercion.

[23]"A serf might run to the town court for protection against his master. A vassal might run to the king's court for protection against his lord. A cleric might run to the ecclesiastical court for protection against the king" (Berman 1983, p. 10). See also pp. 292–94 and pp. 542–43. Rather than seeing the Middle Ages as a stagnant period of serfdom, Berman argues that it was a revolutionary period during which the Western legal tradition started to take form.

Private Articulation of Legal Precedents

The next issue—the incentives of private arbitrators to articulate precedents—again finds Landes and Posner providing at least part of the reply to their own concern. At one point, Landes and Posner (1979, pp. 257–58) argue that commercial arbitrators do not set precedents but just apply those established by government courts. They recognize, however, that the Law Merchant system of the Middle Ages, which involved the use of private courts and law for the adjudication of commercial disputes, developed a large, some would say phenomenal, body of precedents. This body of precedents was eventually absorbed into government law as royal courts competed for clients against merchant courts. In England in 1606, however, Lord (Edward) Coke asserted that the rulings of merchant courts could be countermanded by royal tribunals, and the Law Merchant declined vis-à-vis public courts. Thereafter, the development of commercial law precedents slowed, and merchants gradually started going back to private arbitration (Trakman 1983, pp. 25–26). Landes and Posner (1979, p. 258) note that the renewed competition apparently stimulated important procedural reforms in England in the 19th century, and in the 20th century private arbitration has again become a major factor in settling commercial disputes. In many respects, then, the causation with regard to who sets and who just applies precedents has run from private to public sector.

In a private legal system, the articulation of clear and unbiased precedents would be a matter of self-interest for courts insofar as it is a way of establishing brand-name capital. Landes and Posner are aware of this, but argue that private courts would not have an interest in precedents if cheaper forms of advertising existed (Landes and Posner 1979, p. 239).

From a more dynamic perspective, however, one can see why the incentives to articulate precedents would be likely to dominate. First, one can envision a market in legal decisions in which enterprising courts would sell the written opinions of their judges to law firms or to the various retrieval services on which lawyers rely (Barnett 1986, p. 38). Beyond this, one would expect the formation of insurance organizations to help individuals and firms pool risks with respect to liability and litigation costs. Individuals or firms could pay a flat fee to such organizations, as is the case with today's Health Maintenance Organizations (HMOs) in the field of medical care. To the extent that these organizations had clients with conflicting interests—with some clients more likely to be plaintiffs in certain classes of cases, and other clients more likely to be defendants—

the organizations would have an interest in having courts articulate unbiased precedents, so as to minimize the number of future disputes occurring and, in turn, their costs. These organizations would also have an interest in reducing litigation costs by encouraging law-abiding behavior on the part of their clients. The organizations would thus be a modern-day version of the surety associations that developed under primitive legal systems such as that of the Yurok Indians (Goldschmidt 1951, p. 512) and that also appeared in both medieval Europe and Iceland.[24]

In a private legal system, one would expect courts to compete with each other to establish contractual arrangements with such organizations. The organizations would agree in advance to bring their disputes to those tribunals that had reputations for setting clear precedents—precedents being a legal version of preventive medicine. Even if a legal insurance organization had clients whose future concerns were totally biased (e.g., they were all sellers of a particular product known to be hazardous), the court with whom that organization does business might at the same time have contractual arrangements with other insurance organizations having diametrically opposed future concerns (e.g., they might represent consumer groups). Of course, if a court were known to issue biased rulings, we would be back at the question of whether private courts would dispense impartial justice. In any event, it seems clear that there would be ample incentives to put forth precedents.

By contrast, it is not clear that the incentives facing public courts are as strong. To some extent, judges may wish to articulate precedents as a way of acquiring prestige, but insofar as litigants' fees in public courts are below market-clearing rates, there is an excess demand for court services—the so-called caseload crisis. Tribunals may then—either deliberately or because of force of circumstance—ration scarce court time by avoiding or delaying precedent-setting cases.

Standardization of Legal Rules

As is true for the issue of precedents, the question of legal uniformity provides a good case study for what Harold Demsetz (1969, p. 1) has called the "comparative institutions" approach to questions of public policy. To say that private institutions would not provide the degree of uniformity that would be neoclassically optimal under zero

[24]On the use of sureties in medieval Ireland, see Peden (1977). On the Anglo-Saxon tradition, see Stephen (n.d., Vol. 1, pp. 65–67). See also Blair (1956, pp. 232–35). On the use of sureties in medieval Iceland, see Friedman (1979). It should be noted that in medieval times membership in a surety was often compulsory.

transactions costs is not to say that government institutions—which operate under positive transactions costs—produce a better result. One must compare the reality of a set of institutions with the reality of the other, not the reality of a set with the result one idealizes the other set is capable of producing under certain hypotheticals.

Commercial law again stands out. When one examines its history, one sees a pattern of behavior on the part of legislative bodies with regard to standardizing legal rules; this pattern is mixed at best. The development and adoption of the Uniform Commercial Code may seem to be a good example of an instance where legislative activity eventually helped to rationalize a melange of laws that had previously governed commerce. On the other hand, the existence of a problem to be solved was a result of the fact that government institutions did not produce legal uniformity. There were, and are, multiple state jurisdictions with often-conflicting rules. Moreover, the Uniform Commercial Code was based primarily on the principles of the Law Merchant; "the positive law of the realm was forced to conform to the mandates of the merchants, not vice versa" (Trakman 1983, p. 34).

On an international scale, the problems of multiple governmental jurisdictions have been even more pronounced, often leading to wars, and private arbitration has reemerged as a potent force in the 20th century, in part to promote greater legal uniformity than occurs under public jurisdictions separated by arbitrary political boundaries.[25] The International Chamber of Commerce Court of Arbitration, established in 1923, is one of more than 120 private organizations that help to adjudicate international trade disputes (Lazarus et al. 1965, p. 29). Many of these organizations focus on disputes regarding particular products. Others specialize on a territorial basis. The jurisdictions overlap and are free to evolve spontaneously. The establishment of various public jurisdictions in the form of nation-states and provinces has not been subject to such a discovery procedure.

A similar contrast between the public and private sectors was evident centuries ago. The universal character of the Law Merchant has been stressed by almost every scholar who has written about it.[26] Local government laws, however, often discriminated against

[25]One might ask why competing private agencies such as those under discussion would not be just as likely as nation-states to generate armed conflict on a mass scale. The brief answer is that the leaders of nation-states can more easily compel their subjects to subsidize the costs of their excesses.

[26]"Each country, it may almost be said each town, had its own variety of Law Merchant, yet all were but varieties of the same species. Everywhere the leading principles and the most important rules were the same, or tended to become the same" (Mitchell 1904, p. 9).

"merchant strangers." They still do, as evidenced by modern protectionism.

Of course, law must to some extent show local variations to reflect differences in conditions and customs, and privately produced law has done this, a point stressed by Anderson and Hill (1979) as well as by Mitchell (1904). The common law has also at times shown an admirable degree of variation in its rules regarding, for example, water rights and liability for stray cattle (Posner 1987, p. 6). On the other hand, public authorities have often imposed uniformity where it is not called for, such as the U.S. government's setting of motor-vehicle speed limits that do not distinguish between conditions in New Jersey and Nevada.

But the more important point is that the degree of the law's uniformity that does, in fact, emerge under more pluralistic legal institutions (e.g., the Law Merchant) contributes to the view that there exists a rule of law that is independent of the will of state rulers. Indeed, the existence of pluralistic legal institutions makes the rule of law necessary as a means of economizing on the costs of resolving disputes among courts with overlapping jurisdictions. And the rule of law is the protector of liberty.

Problems of Large Numbers of Small Claims

Cases involving large numbers of potential litigants pose severe problems for any legal system. To be sure, litigation is often desirable as a means of resolving disputes and making people internalize the effects their actions may have on others. Litigation involves costs, however, and at some point these costs may be overwhelming.

The automobile has generated perhaps the most striking examples. Consider accidents and auto insurance. The litigation costs involved in determining who is to be held responsible for accidents have in some states become so enormous that they have accounted for 50 percent or more of people's auto insurance premiums. Assume for the sake of argument that moving to a system of no-fault insurance would be the most economical solution. Would there exist in a private legal system incentives for moving to such a system? Would private courts not welcome litigation as a boon to their profits?

Businesses, including private courts, certainly welcome a strong demand for their products, but one must be careful about exactly what it is that people want. Depending on the circumstances, people demand litigation-avoidance rather than litigation. More specifically, one would expect insurance companies in a private legal system to associate only with those courts that economized on the need for litigation. This association would be the private sector counterpart

to companies' lobbying of politicians for no-fault insurance under current institutions. In a private legal system an enterprising court could announce that, effective on such-and-such a date, it would offer new contractual terms for insurance companies so that, in return for a flat fee that was based on a company's past involvement in legal disputes, the court would hear any cases the company wished to bring before it during the next 12 months—under the proviso that the court would refuse to assign fault in accident cases involving motor vehicles. Assuming insurance companies would prefer a no-fault system, such a court could charge lower fees and gain a competitive edge.

Now suppose Insurance Company X associates with Court A, which has a no-fault stance, but Insurance Company Y is associated with Court B, which has continued to assign fault in car-accident cases. What would happen if a driver with a Company X insurance policy had an accident involving a driver with a Company Y policy? One would then simply have a special case of the more general issue of conflict-of-laws across jurisdictions. As noted previously,[27] the principles involved in resolving such conflicts developed spontaneously, with nonviolence proving to be economical. In the long run, one would, of course, expect courts like Court B to shift to a no-fault stance in car-accident cases if no-fault were found to be an advantageous approach. Perhaps no-fault would prove to be appropriate for some classes of accidents, but not for others. There is no way to know for sure without an effective discovery procedure.

A second crucial issue generated by the automobile concerns air pollution. Again, if cases were brought before courts on an individual basis, huge numbers of litigants could potentially be involved—the millions of automobile drivers, the companies that make automobiles and their fuel, and the untold numbers of victims of pollution. From the standpoint of an individual pollution victim, the damages suffered might be significant, but the victim might be uncertain about precisely who caused them, and the expected costs of investigating and litigating the matter might be greater than the damages.

If there were a large number of people who might be eligible for damages, however, a class action suit would be an obvious possibility because there might be economies of scale in litigation. Against this possibility is the fact that even if such a suit could be filed, it might be very costly to determine the total damages suffered and to apportion them among the parties to the class action. There would be further difficulties in defining what the appropriate class would be

[27]Supra note 18.

and in deciding if and under what conditions nonparticipants in class actions would be ineligible to file additional suites.[28] In *Roger J. Diamond v. General Motors*, a California Superior Court judge ruled that an attempt to sue General Motors and other parties in a class action suit on behalf of all the property owners in Los Angeles was not the proper way to deal with the problem of smog. The appeals court affirmed the decision, noting both the difficulties of individualizing damage claims and the traditional role of government legislation in addressing concerns about public nuisances.[29]

It might well be that at some point, it is not worthwhile to try to individualize damages. Public regulation does not do so at all. In a private legal system, on the other hand, legal entrepreneurs would be free to try to organize class actions in any way they wished. A class-action lawyer might propose, for example, that people with certain documentable respiratory problems be entitled to a certain percentage of the total damage award, but that no serious attempt would be made to establish that Person J's problem merited, say, 6.4 percent more in compensation than Person K's. The fineness of the damage categories would itself be an object of discovery.

The number of defendants involved and the burden of proof would also have to be resolved. With regard to the former, it is often not economical to pinpoint all the people and organizations who contributed to one's damages, nor to try to determine the proportion of the damages attributable to each culpable party. In the case of *Roger J. Diamond v. General Motors*, the plaintiff tried to identify 293 corporations and municipalities as appropriate defendants and was unable, of course, to specify exactly how much each party had contributed to smog in Los Angeles, let alone the connection between smog and damages to individual people and properties. To cope with such situations, the law has developed the doctrine of joint and several liability, whereby one, or just a few of the parties, can be sued for all the damages, with the selected parties then having a right in some circumstances to collect compensation from culpable parties who were not originally sued (Posner 1986, pp. 171–74).[30]

[28]For further discussion of such issues, see Kornhauser (1983).

[29]20 C.A. 3d 374 (1971). One might argue that holding auto manufacturers instead of drivers responsible for pollution is like holding gun manufacturers and not gun users responsible for murders, but as Ronald Coase (1960) has pointed out, the relevant issue from an economic standpoint is what liability assignment best economizes on transactions costs.

[30]It should be made clear that the doctrine was originally developed in non–class action settings.

As regards the burden of proof, the central issue in many environmental cases is the difficulty that victims have in establishing that particular, usually industrial, activities and not something else were indeed the cause of their injuries. Thus, for an individual to show convincingly that the release of chlorofluorocarbons into the atmosphere was the cause of his skin cancer might be prohibitively costly. To cope with such cases, Japanese courts have ruled that in certain, very limited circumstances the plaintiff need show only a strong statistical correlation between his type of injury and the defendant's activity, and the burden of proof is then on the defendant to show that he probably did not cause the plaintiff's injuries (Tietenberg 1988, pp. 448–49). There is, of course, great uncertainty about the seriousness and character of many of these environmental matters (uncertainty that would exist under any legal system). But putting what is called a sequential burden of proof on the defendant, as has now been done in Japan, may be efficient if people are generally averse to environmental risks, and if defendants can acquire information for resolving such disputes at lower cost than plaintiffs.

So imagine a class action in the Los Angeles area under a private legal system in which a law firm organizes a "petition drive" among various categories of potential claimants who sue, say 10 automakers—perhaps only those 10 firms—for all the damages attributable to abnormal concentrations of carbon monoxide, ozone, and nitrogen dioxide in the air. The suit would be based on statistical correlations between unusually high rates of incidence of certain disorders and the presence of these pollutants. Imagine the incentives that automobile manufacturers would have to spontaneously modify the design of their cars if they knew such suits were possible. (In a private legal system, they would have perhaps designed cars differently long ago, when the situation was not so unwieldy.) Is it really obvious that private courts would thereby constitute a less-effective way of dealing with automobile pollution than the reality of current institutions? Similar questions can be posed with respect to the depletion of ozone in the atmosphere and several other environmental concerns.[31]

It must be emphasized that it is precisely because of the difficulty of the legal issues discussed above that an innovative, spontaneous process of discovery is so urgent. If people protest that some firms would be bankrupted by the damages they would have to pay in

[31]Pollution from stationary sources such as factories would presumably pose a simpler problem than that from motor vehicles. Class action suits might again be feasible, but it is also conveivable that courts would rule that initial polluters had homesteaded (limited) property rights in emissions, with the rights then being transferable from one stationary source to another.

some of these environmental suits, those damages are evidence of the moral "bankruptcy" of current institutions, which have permitted injurious behavior to go on to such an extent. The problems might not be so difficult now if different institutions had been around from the beginning.

Private Protection of Legal Rights

The fifth point of controversy that must be addressed concerns the operation of private protection agencies. Would they involve substantial uninternalized benefits? Would they constitute a natural monopoly that would become a state or dominate society?

Private security agencies have multiplied like rabbits as people have perceived the public police to be inadequate, and one can see the means they have used to internalize the effects of their actions. The argument for the existence of externalities has again been that the deterrent effects of patrols and other enforcement activities on would-be criminals confer spillover benefits on neighbors who did not pay for the security provided. In the case of individual homeowners, however, the market response has been to put signs on the premises informing those passing by that the property is under the purview of such-and-such an agency. The implicit message is that the homes without such signs are *not* protected by that agency.

In a similar vein, the American Automobile Association (AAA) gives its members decals that they can put on their cars to inform people that, if a member's car is stolen, AAA will pay a reward for information leading to its recovery (Friedman 1979, p. 403). Cars without these decals do not have such protection. The point is that people *can* be excluded from security if they do not pay for it; spillover benefits need not exist.

On a larger scale, the market process has evolved as it has in many other instances of potential spillovers: by promoting innovative contracts and institutions to internalize the would-be externalities. Associations of condominium owners often purchase security for an entire area. Storekeepers in malls collectively purchase private protection. Individuals can choose to live in apartment buildings that offer guards or other forms of security. If the public police and the associated taxes were eliminated, one would expect to see ever-more diverse types of protection paid for by homeowners' associations and merchant groups. Most real-estate contracts would probably have the purchase of security be a condition for buying property. To the extent that entities such as streets and parks were privatized, private security could also be provided in what are now "commons" areas.

As far as the natural monopoly[32] issue is concerned, it should first be noted how many thousands of security agencies are presently across the United States. (The same applies to arbitration services.) A quick look at the Yellow Pages of any major city's telephone directory reveals dozens of firms offering protection of one sort or another. To say, as Buchanan does, "conflicts may occur, and one agency will win," is to assume that agencies continually fight each other until only a single one is left instead of settling disputes in a more peaceful, lower-cost fashion that enables many firms to survive and prosper.

Several examples of stateless societies serviced by private protection efforts have existed in history. Some of these societies lasted far longer than countries that tried to forestall a general outbreak of lawlessness by subjugating a state to a constitution. If those stateless societies did eventually perish or themselves produce states, however, one must explain why.

After five centuries of relative stability, Celtic Ireland and its private legal system were conquered by the British after an additional four centuries of struggle. Britain itself developed a centralized government out of tribal groups as a response to attacks from the Vikings, especially the Danes (Blair 1956, pp. 201–3). The private legal system of medieval Iceland apparently became increasingly centralized and finally broke down in the face of threats from Denmark and Norway.[33] In an oft-cited study of the development of nation-states, Franz Oppenheimer (1926) thus emphasized how states have arisen because of external factors (e.g., threats from outside enemies). It may be that a free market can support a multiplicity of private protection agencies for tremendously long periods when a whole area is not threatened by an outside force (e.g., a state). If the area *is* so threatened, however, market forces may generate a concentration of protection efforts in the endangered area as a response. The concentration of protective forces at some point itself becomes a state.

One must be careful, however, about claiming that stateless societies generate states only as a defensive measure against other states,

[32]One must distinguish "natural monopoly" in the technical sense of "large economies of scale" from "natural monopoly" in the sense of "it has usually ended up as a monopoly." For example, in most developed countries, post offices are virtual monopolies. They thus seem to be "natural" monopolies in the second sense noted above, although there are grave doubts about whether they are natural monopolies in the first sense noted above. We are speaking in the text of the possibility that protection agencies are a natural monopoly in the first sense.

[33]The author claims no expertise on this matter. I owe the statement in the text to an Icelandic political scientist, Hannes Gissurarson. He grants that it is a matter requiring further research. David Friedman (1979, p. 407n) speculates that an increasingly concentrated distribution of wealth may also have played a role in Iceland.

for this would fail to account for the emergence of the very first state. It may thus be that there *are* occasions when the provision of protective services is a natural monopoly—perhaps when a climate of mistrust develops between sizable groups of people from distinct territories.[34] And if defense (or offense) is to be provided on a large scale, familiar public-good issues arise, perhaps leading to demands that the effort be supported by taxation, conscription, or the creation of fiat money. Needless to say, a purely private legal system would not survive in such conditions.

Social Conventions in a Private System of Law

The final area of controversy is the values (i.e., the social norms or "moral code") that would underlie a nongovernmental system of law. Hirshleifer (1982, p. 37) has argued that just because a group of people converges on a particular set of values does not mean that it has converged on the *best* set of values. On the other hand, Ellickson (1987, pp. 98–99) has argued that, if group members have repeated contact with one another, a free environment will lead to the emergence and general observance of values that are neoclassically efficient.[35]

The efficacy of a group's values is very important for two reasons. First, law grows out of some sense of morality. If the sense of morality that dominates a society is warped in some way, the law is likely to become warped as well. Second, it must be remarked how infrequently most people use the formal apparatus of law. Surveys, for example, reveal that most people know very little about the legal rules that allegedly constrain their behavior (Ellickson 1987, p. 88), and almost two-thirds of the adults in the United States have used an attorney only once in their life or not at all (Ellickson 1987, pp. 89–90). The law is, of course, important, but less-formal norms would appear to be the biggest influence on how people interact with one another.

Much use has now been made of evolutionary theory in an attempt to explain how norms emerge and survive (or perish). Hayek (1984, pp. 318–30; 1988, chap. 1), for example, has drawn analogies between cultural and biological evolution and has spoken of a "group selection" process whereby those species or groups that have advanta-

[34]Posner's study of Homeric society lends support to Oppenheimer's view, but he does not rule out the possibility of states having emerged because of a concentration of wealth or because of demand for large-scale public projects. See Posner (1981, pp. 143–45, 163–65).

[35]Ellickson's argument is based on the principles articulated in Axelrod (1984) [private communication]. See also Smith ([1759] 1976, Part VI, Section II).

geous traits or norms are likely to prevail, while species or groups with dysfunctional traits or norms are likely to suffer a decline. One complaint about such analyses is that it has been argued in the biological literature that, strictly speaking, evolutionary processes select individuals or genes, not groups (Wilson 1975, pp. 106–29).[36] Thus, a norm of honesty may be generally beneficial to a group, but dishonest individuals within that group may be able to profit at the expense of honest individuals. So dishonest individuals may prevail (Ellickson 1987, p. 95).[37]

In other words, a free-rider (public-good) problem may plague the enforcement of a desirable norm. Most individuals within the group would benefit if everyone else obeyed the norm, but each person considered separately might often benefit by violating it.[38] Recall that Ellickson qualifies his claim about norms being efficient by saying that there must be repeated contact among group members. The rationale for his qualification is that if group members see each other regularly, they are more likely to develop informal sanctions against what is perceived as asocial conduct. This setting of norms is especially so in groups that are relatively small, where it does not cost individuals much to monitor one another. As an example, a rude person can be singled out and excluded from social activities; rudeness can thereby be lessened. If people don't see each other regularly, however, asocial behavior may go unpunished. In the large cities of a mobile society, for example, some people may be offended if Person X drives too aggressively, but Person X is unlikely to encounter those exact people again so why care if they dislike him or her?

Ideally, there would be some external, omniscient force that would sanction wrongdoers like Person X, but government is certainly not it. General civility cannot be imposed by force. God and the fear of the Last Judgment have been suggested as an alternative means of motivating individuals, and Hayek (an agnostic) has, in fact, put great stress on the role that religion has sometimes played in supporting

[36]One can take comfort from the fact that many other animal species observe property rights—crayfish, certain butterflies, etc.—but the relevance of these biological data for forming a positive theory of social evolution among humans is controversial, to say the least.

[37]Whatever the merits of his theory of cultural evolution, Hayek (1988, p. 25) maintains that it does not depend on the existence of group selection in the biological world.

[38]A free-rider problem can likewise inhibit a change in norms; people might be predisposed to change, but there may be situations in which each individual will refrain from changing until others do the same. Thus no one changes (Vanberg 1986, p. 93).

Western values (Hayek 1988, chap. 9). At other times, of course, religion has played an opposite role.

Insofar as our analysis has maintained that respect for private property and related values is of paramount importance to the operation of an effective discovery procedure, processes of "group selection"—if we may use that term—do appear to work in their favor. Group selection accounts for the perennial net migrations of people from countries where there is relatively little respect for private property to areas where there is relatively more, and this movement has certainly helped the institution of private property to survive (while at the same time helping to delegitimize societies that are hostile to it). The prospects of greater economic success and greater liberty seem to be the main factors driving these net migration flows.

There is, on the other hand, no guarantee that areas where private property prevails will not rot from within, because of the free-rider problem discussed above. There is no invisible-hand process to ensure that a religion or any other compelling ideology will always be there to prevent cultural decline. In the extreme, there could be such discord with respect to values that the model sketched early in this paper could degenerate from a state of anarchy in the sense of "no government" to anarchy in its literal sense, meaning "without rules; chaos." As an individual, all one can do is exercise free will on behalf of the values and ideology in which one believes. One recalls the famous remark attributed to Jefferson: "Eternal vigilance is the price of liberty." (Since the family has for ages served as a repository of cultural values, the importance of sound family law—the rules governing marriage, divorce, and children—should also be mentioned in this context.)

One should not underestimate the capacity of "vigilance" and informal sanctions, plus simple inertia,[39] to support a group's functional traditions. After an elaborate study of the matter, Robert Sugden (1986, p. 177) went so far as to conclude simply: ". . . the morality of spontaneous order is conservative." A *strength* of a nongovernmental system may also be that, if a disagreement about fundamental values does arise, no one has a state readily available through which he can try to impose or subsidize his views.

Implications

As noted in the introduction, viewing law as a discovery procedure yields "some interesting consequences that are not so obvious." An

[39]Ibid.

exhaustive discussion would require a separate paper, but a few of these consequences are highlighted below.

Tort and Contract Law

In combination with the use of injunctions, "strict liability" is often said to be "the" Austrian position on tort issues. A policy of strict liability means assigning responsibility to a party for any damages emanating from his person or property, regardless of whether he was at fault. If Party A is damaging Party B, making A subject to an injunction forces A to bargain with B if he wants to continue his activity. A and B can then use their knowledge of "circumstances of time and place" to arrive at a mutually agreeable outcome. If B insists on compensation that exceeds the subjective value that A places on the activity, it is evidence that the activity is not worthwhile. A flat rule of strict liability, which leaves judges with little discretion, also adds to the certainty of the law, thereby further helping individuals to coordinate their actions.

The more thoroughgoing Austrian analysis in this paper casts doubt on what has been previously thought to be "the" Austrian position. It is well known (Cooter and Ulen 1988, pp. 367–71) that the efficacy of a policy of strict-liability-with-injunctions is doubtful if bargaining costs are extraordinarily high, and if plaintiffs in tort cases can provide protection for themselves at a much lower cost than defendants. To be sure, judges who follow a doctrine that imposes liability only if the defendant is judged to have been at fault cannot know all the circumstances of time and place that are relevant to a neoclassically efficient outcome. But these judges might still generate results that consumers of court services in a private legal system would sometimes prefer ex ante to strict liability. A thoroughgoing Austrian position would thus maintain that the extent to which strict liability prevails should be the object of a discovery procedure. The issue could be resolved in a market for court services.

A similar conclusion must be drawn in analyzing the use of a remedy of "specific performance" as opposed to payment of compensatory damages in cases of breach of contract. Austrians often favor specific performance because it forces someone breaching a contract to create (approximately) the subjective experience that the plaintiff expected to be forthcoming when he signed the agreement. As is true of strict liability, adherence to such a doctrine also creates an element of certainty in relationships; this certainty helps individuals coordinate their actions. Suppose, however, that a party almost fulfilled a contract—almost, but not quite. For example, suppose Party A built a beautiful mansion that was almost exactly what Party B

specified in their contract—almost, but not quite. For example, suppose Party A built a beautiful mansion that was almost exactly what Party B specified in their contract—almost, but not quite. Suppose also that B paid for the house in advance. What if specific performance would require A to incur hundreds of thousands of dollars of costs to rebuild the entire mansion? A private court might nix specific performance and instead ask A to pay compensatory damages to B. To be sure, no judge would know the "correct" damage award that would generate precisely the "proper" subjective experience for B, but there are undoubtedly occasions when compensatory damages would be preferable to all parties concerned, especially if high bargaining costs existed to hinder A and B from negotiating a settlement among themselves. Again, the matter could be resolved in a market for courts. Thus, in comparison to a court that imposed a remedy of specific performance, both A and B in the example above would prefer a court that set compensatory damages at an amount that was more than the loss of subjective value to B from the breach, but less than the cost of rebuilding the mansion.

Consider one additional issue: In the absence of explicit contracts on the matter, should the law treat bank deposits as bailments, thereby mandating 100 percent reserve banking? Or should fractional reserve banking be permitted? The common law and modern legislation have not treated deposits as bailments. Given the opportunity costs of holding bank reserves, one might not expect a 100 percent reserve system to prevail even under privately articulated law, but one cannot be sure in advance. The outcome would also depend on consumers' desires for deposit insurance and on whether treating deposits as bailments turned out to be a low-cost way of providing at least some of the insurance demanded.

The Relationship between Law and Morality

It should be clear from what has already been said that, from the perspective of this paper, no fixed line can be drawn to separate law and morality. Morality refers to certain rules that ought to guide human conduct, regardless of whether these rules are articulated and enforced in a formal way. Law, on the other hand, is the formal enterprise of making certain rules explicit and then seeing that some attempt is made to enforce them. At what point should lying be subject to legal sanctions? Not when ordinary schoolchildren tell falsehoods to each other during recess. Should the law regulate abortions at some point? Firm answers to such questions presuppose knowledge that no individual possesses. The answers depend on complex circumstances concerning the fact patterns of different

cases, people's values and preferences, and the costs of operating various types of legal enterprises. The questions can be addressed in two basic ways: by some degree of central planning, or through a market process. The latter at least offers the prospect of uncovering the information that is relevant for deciding when it is worthwhile to resort to the formal enterprises of the law.

The Relationship between Individual Rights and Utility

The perspective of this paper has been one of natural rights and natural law, in the sense that rights and the law are viewed as existing independent of the will of some sovereign power. In this sense, the view of the law here is diametrically opposed to that of legal positivism. On the other hand, this paper has not viewed rights and the law as fixed along the lines of an absolutist model. It must be stressed that this approach is different from viewing them as arbitrary.

In a broad sense, rights and the law are seen here as the product of interaction between individual preferences and ever-present constraints on the information and other resources people can possess or acquire. Rights and the law can thereby be seen as social outcomes in the same sense as prices and quantities. They would not, however, be likely to change anywhere near as often, and could, of course, be expected to command a stronger emotional allegiance. From a thoroughgoing market process perspective, neither prices and quantities nor rights and the law are seen as arbitrary.

Speaking more concretely, the paper emphasizes that a deep respect for rights of private property (and the liberty they secure) is the *sine qua non* of the system under discussion. At the same time, the paper has argued that in some cases a process of articulating and enforcing a complete set of private rights is probably too costly. As in other matters, resource scarcity would constrain what people would choose to do.

In an ultimate sense, then, the moral-philosophical outlook here is one of a system of rights with a utilitarian basis that would help individuals coordinate their respective plans and generate a spontaneous order. The system would do this by unearthing and spreading information about not-yet-exhausted gains from trade. This is not to say, however, that individuals would at all times be led to maximize either their own or others' utility. Recall, for example, that one key feature of a competitive discovery procedure is negative feedback. The main reason for relying on a discovery procedure and for eschewing a direct, satisfaction-maximization version of utilitarianism would

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again be that no one can ever know enough to make "the good of Mankind" an ever-present, operative goal.

We thus fall back to an "indirect" (or "rule") utilitarianism in which we hit upon certain, somewhat contingent guidelines or "rights" to influence how we act.[40] Since another essential aspect of the system is having individuals use their separate bits of knowledge to pursue their separate purposes, these rights would tell people what they must *not* do, rather than what they must. Given our ignorance, there would always be cases where letting our choices be influenced by the received rights and rules would seem harmful, but once more, we would have to put aside our temptations and conceits and put more faith in a process than in our ability to plan a whole set of outcomes in advance. An emotional attachment to "rights" that exist independent of direct, short-run considerations of utility would thus be a vital aspect of the system and, hence, of the freedom it involves. It should be remembered that in an indirect, overall, long-run sense, these rights *would* have instrumental value. The paradox is that the more we viewed them as instruments, the more our constructivistic impulses and conceits would tempt us to abridge them for some immediate gain.

Anarchism versus Libertarianism

Let us define "strict" libertarianism as a politico-economic system in which the legal rights to property and contract would be absolute. In such a system, a person would have a legal right to use, or not to use, his property (including himself) in any way he liked, as long as he did not infringe on others' rights to do the same. A private owner of a tropical island, for example, would be legally entitled to forbid a desperate castaway from setting foot on his property. Let us define "ultrastrict" libertarianism as a version of strict libertarianism in which "infringements" of property rights would refer only to physical invasions, such as theft, or to certain other actions deemed equivalent to theft, such as fraud. Under ultrastrict libertarianism, a person could not, for example, claim even a limited property right to a reputation, as can be done under modern Western law; ultrastrict libertarianism would thus rule out laws against slander and libel.

Many discussions of libertarianism take up one area of life after another, purporting to show how various problems could be dealt with through the actions of private individuals, subject only to gen-

[40]The terms "direct"and"indirect" utilitarianism were introduced in Singer (1961). The role of imperfect information in leading to indirect or "rule" utilitarianism is discussed in Hayek (1976, chap. 7).

eral rules of property and contract. Anarchism is then viewed as an extreme form of libertarianism in which even the legal system would be governed by the actions of individuals vested with (absolute) private rights.

This paper has cast doubt on the germaneness of such a perspective. As previously discussed, the legal rights to property and contract would probably not be absolute in a private legal system. To some extent, then, the system might not be purely libertarian. Nor would a private legal system necessarily consider a person's legal rights to be infringed only if he (or his tangible property) had been physically invaded or defrauded. In the private legal system of Celtic Ireland, for example, jurists not only asserted an eminent domain power; they articulated laws against libel, made allowances for physical invasions of property in certain emergency situations, and even allowed certain relatives of a property owner to veto the sale of his land (Peden 1977). To be sure, the Irish system showed a deep respect for private property, and perhaps some of these rulings would have been modified had the system lasted even longer than it did, but the rulings illustrate the nonabsolutist character of an historical episode worthy of further study.

People can, of course, try to persuade others, including the judges in a future private legal system, to adopt a philosophy of strict, or even ultrastrict, "anarcho-libertarianism," just as they can try to persuade today's legislators to enact a particular combination of policies or, for that matter, persuade private enterprises to sell particular products at particular prices. The problem is that people in whatever politico-economic system is under discussion are faced with incentives that are not systematically consistent with the particular actions being asked of them. Thus, if an ideological movement succeeded in bringing about a pure state of anarcho-libertarianism (as improbable as that seems), this result would probably not constitute a stable politico-economic equilibrium. This is not to denigrate the general power of ideas and ideologies to sway events, but simply to say that there is no invisible-hand mechanism that can be counted on to direct the content of ideologies so as to make a very specific set of social outcomes likely to persist for an extended period.[41]

Conclusion

By focusing our attention on processes of discovery, Hayek has given us a way of looking at the world that has only begun to be

[41]For a line of argumentation that is not inconsistent with the foregoing, see Friedman (1989, chap. 31).

appreciated. The notion of a discovery process has long been present in the study of law, but in recent times the idea has been drowned by the flood of writings espousing various forms of legal positivism. Now, though, through the midwifery of Austrian economics, the concept of a discovery procedure has a chance for rebirth among legal scholars, albeit in a new form. Previously, legal scholars have spoken of the discovery procedure of the common law, whereas a thoroughgoing Austrian approach would have us seriously consider the potential of a private legal system to uncover rules and institutions conducive to spontaneous order. In this regard, this paper has suggested that Hayek himself may not have pushed the analysis sufficiently far. Even if one rejects a private legal system, one can perhaps appreciate the way in which the exercise of conceptualizing it has pointed toward certain general principles that can help guide the resolution of legal issues. Among these principles are nonabsolutism, a long-run indirect version of utilitarianism, natural rights that are resistant to immediate utilitarian concerns, and legal doctrines manifesting respect for the division of knowledge in society.

While all the criticisms of a private legal system made by Landes and Posner and others merit much more discussion, at this point the argument for such a system seems weakest in the following respects: (1) Especially in areas threatened by external forces, such as predator states, one cannot dismiss lightly the concern that protection agencies may constitute natural monopolies; (2) there may be public-good/prisoner-dilemma situations such that even those wary of government powers would deem a state to be a necessary evil; and (3) the process that is to guide the formation and sustenance of norms and values does not inspire great confidence. As previously discussed, this last concern can be seen as a special case of the second concern above.

One can favor a stateless system, believe it could be reasonably stable for an extended period, and still conclude that, like it or not, the system would eventually break down or evolve into something else. The same can be said with regard to a system of limited government. Nothing lasts forever, and to arrive at this or any other truism one does not need much of a discovery procedure.

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