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Separation of Law and State

Talia Fisher

Tel Aviv University Law School

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Talia Fisher*

In the framework of the jurisprudential literature, the law-state bond is assumed as a given. Points of dispute emerge only at more advanced stages of the discussion, with respect to such questions as the duty to obey state law or the appropriate extent of state intervention in social relations. This Article will be devoted to a reconsideration of the presupposition of the law-state link and to challenging the state's status vis-à-vis the law—both in its role as the producer of legal norms and its capacity as the arbiter of disputes.

The Article opens with a comparative elucidation of the Hobbesian and Lockean justifications for the existence of the state and its intervention in the law. The first Part of this Article analyzes the “ills” of the State of Nature, reviewing the range of failures that accompany market supply of the legislative and judicial functions. These derive from the public good characteristics of legislative and judicial services, from the fact that law is a network industry, and from the cartelization tendency in the legislative and judicial markets. Based on these failures in organizing social behavior in the State of Nature, Hobbes's and Locke's theories of the social contract justify the concentration of the legislative and judicial functions in the hands of the state sovereign and grant it a monopoly over these functions.

The second Part of this Article critiques Hobbes's and Locke's conclusions, first and foremost their disregard for the flaws of the public model, which they support. An implicit premise of both the Hobbesian and Lockean justifications for state law is that where the private market fails, the state will necessarily fare better. However, there is a cost to state intervention, and public supply of legislative and judicial services is not without flaws. Proponents of the public state law model must therefore further show that this model generates more efficient results than those produced by the private model. The second line of criticism will argue that the matter is not resolved even if we assume that the fully privatized model is a

* Assistant Professor, Tel Aviv University Law School. I wish to dedicate this Article to the memory of my teacher, Professor Stephen Goldstein, whose great wisdom, kindness and modesty will always be a source of inspiration. For helpful comments and suggestions, I would like to thank Daphne Barak-Erez, Shai Dotan, David Enoch, Alon Harel, Roy Kretiner, Menny Mautner, Ariel Porat, and Eytan Sheshinski. Dana Rothman provided invaluable editorial assistance. I am also very grateful to the editors of the *University of Michigan Journal of Law Reform* for their great help and insightful comments.

less attractive option for the supply of law than the fully public alternative. These two extreme alternatives do not exhaust the entire spectrum of possibilities for the law-state connection. Rather, between these two polar ends there may be intermediate forms of limited state intervention in the markets for legislation and adjudication. These configurations rest on the abandonment of the dichotomy that characterizes Hobbes's and Locke's doctrines, between a monolithic public legal order and sweeping non-intervention in the law on the part of the state. This Article closes by presenting a possible median point along the axis that illustrates the possibility of correcting the failures of the legislative and judicial markets in the framework of a polycentric legal regime based on more limited state intervention in these areas. The conclusion offered will be that while the ills of the State of Nature, as identified by Hobbes and Locke, are valid justifications of state intervention per se in the legislative and judicial markets, they do not justify intervention in the form of a state monopoly over the law. State intervention in legislation and adjudication is vital for creating the space in which legal regimes can grow—where rights can be set and adjudication conducted in light of those rights. There is absolutely no need, and therefore no justification, for the state to hold the sole power to set these rights itself and decide disputes in light thereof.

INTRODUCTION

The law and the state appear to be inextricably intertwined. The term “law” immediately conjures up the image of the state law, the craftwork of the legislative and judicial authorities.¹ The state, too, is identified first and foremost with the functions it fills in the areas of legislation and adjudication,² and the law is perceived as its very heart and soul. This perception is expressed in the jurisprudential literature, which is founded on the law-state link, in its natural presumption of the legitimacy of this relationship and the lack of any attempt to trace the origins of the state's authority to intervene in the law. Only at more advanced stages of the literature's discussion

1. The positivist school of thought expresses this approach most incisively in holding that the state dimension of the law constitutes a foundational element in its definition, and that “law” is therefore devoid of any meaning without the state. *See, e.g.*, JOHN AUSTIN, *THE PROVINCE OF JURISPRUDENCE DETERMINED* (Wilfrid E. Rumble ed., Cambridge Univ. Press 1995) (1832); Hans Kelsen, *The Pure Theory of Law and Analytical Jurisprudence*, 55 *HARV. L. REV.* 44 (1942).

2. *See* MIRJAN R. DAMASKA, *THE FACES OF JUSTICE AND STATE AUTHORITY: A COMPARATIVE APPROACH TO THE LEGAL PROCESS* 75 (1986).

is the law-state connection scrutinized, in the context of such issues as the duty to obey the law, the appropriate extent of state intervention in social relations, and the substance of the link between the law and state. The very legitimacy of the state's intervention in law is considered a fundamental, indisputable premise.³

Is this relationship, however, indeed a Gordian knot? This Article is devoted to considering the possibility of unraveling the existing bond between the law⁴ and the state. It will examine the possibility of eliminating the status of the state as sole legislator and arbiter, and of supplying these services instead by the free market. Under the alternative model that will be analyzed, the authority to produce legal rules and decide disputes in accordance with those rules would be dispersed amongst the entire population, in complete autonomy from the state and its institutions. Contracting with suppliers of legislative and adjudicative services will be on a voluntary basis. Parallel legal systems and competing dispute-resolving bodies will coexist within one political and geographic unit, overturning the *a priori* premise of one uniform law. These private legal systems will operate in the market and will be guided by consumer demand. It is important to stress that the paper will not challenge the actual necessity for a legal system to order social behavior. It fully acknowledges the need of every self-preserving

3. The literature in the area of philosophical anarchism has an ideological link to the issue under discussion. See, e.g., CHAIM GANS, *PHILOSOPHICAL ANARCHISM AND POLITICAL DISOBEDIENCE* (1992); JOSEPH RAZ, *The Obligation to Obey the Law*, in *THE AUTHORITY OF LAW: ESSAYS ON LAW AND MORALITY* 233 (1979). However, the philosophical anarchism approach challenges only the duty to obey state law. In this sense, it relates to a far more limited issue than the question of the very authority of the state to intervene in the law and constitute a state law system. See A. John Simmons, *Philosophical Anarchism*, in *FOR AND AGAINST THE STATE* 19 (John T. Sanders & Jan Narveson eds., 1996); Rolf Sartorius, *Political Authority and Political Obligation*, 67 VA. L. REV. 3 (1981); Ilya Somin, *Revitalizing Consent*, 23 HARV. J.L. & PUB. POL'Y 753 (2000).

4. "Law" in the sense of Fuller's broad definition of the term: "[T]he enterprise of subjecting human conduct to the governance of rules . . ." LON L. FULLER, *THE MORALITY OF LAW* 124 (1964). Under this definition, it is possible to include within the scope of the "law" also norms that are extrinsic to the state and lack the features of supreme authority and being universally binding. See JAN NARVESON, *THE LIBERTARIAN IDEA* 221 (1988). On the other hand, this definition also implies that not only is it unnecessary for the state to be the source of a rule or norm for it to become "law," but this feature is not, in itself, a sufficient condition for creating law. In this context, see Andrew P. Morriss, *Miners, Vigilantes & Cattlemen: Overcoming Free Rider Problems in the Private Provision of Law*, 33 LAND & WATER L. REV. 581 (1998). My choice of adopting Fuller's definition of law for the purpose of this Article is motivated by practical considerations as well. This definition regards the law as an enterprise and relates, in this sense, not only to the legal product but also to the process of its creation: to the institutional structures involved in the creation of the law and to the array of incentives that lead to its supply and to compliance with it. For this reason, Fuller's definition is more suited to the economic analysis that lies at the base of this Article. See BRUCE L. BENSON, *THE ENTERPRISE OF LAW: JUSTICE WITHOUT THE STATE* 11-12 (1990).

society to place police and judges at its gates, which are clear and accepted apparatuses for setting behavioral norms and deciding disputes (as well as enforcement bodies). Criticism will, however, be directed at the need for specifically *state* law as well as at the allegedly organic link between the law and the state. In the described sense, the proposed model is aimed at realizing the goal of *freedom of law* as opposed to *freedom from law*. This issue of privatization of the law and its detachment from the state can be viewed as the extension of an ideological continuum that begins with separation of church and state, continues to the capitalistic call for separation of the economy and the state, and then culminates in the revocation of the state's status vis-à-vis the law.

I. THE REASONS FOR A RECONSIDERATION OF THE STATE LAW MODEL

The technological and social transformations of the modern era have diminished the relevance of the law-state and law-territory relationship,⁵ and the extent to which the state law model is suited to the realities of our current way of life has been placed in doubt. In this context, two seemingly opposite trends are notable, both of which embody what can be seen as a challenge to the state law model. The first phenomenon is globalization. The communications revolution has led to an extremely sophisticated ability to make legal transactions that traverse territorial boundaries. The most extreme manifestation of the globalization trend is the ascendancy of the Internet and the legal contracting that is executed in cyberspace. Due to the virtual space in which the Internet operates and the ability of users to act simultaneously from any number of points or to conceal their geographic location, the classic structure of state law, which is territory-contingent,⁶ has ceased to be exhaustive. Indeed, a body of law whose field of operation is delineated according to geo-political boundaries cannot provide an

5. There is room to argue that the detachment of the law from territory is consistent with the distinction between geographic characteristics and characteristics related to values, on which the Aristotelian ideal of the community rests. According to Aristotle, the "state" is not a product of geography alone; rather it is founded, additionally, on a shared value infrastructure. The model under consideration, which cancels the territorial dimension of this equation, thereby resolves the inevitable tension between the two dimensions. See John T. Sanders, *The State of Statelessness*, in FOR AND AGAINST THE STATE 255, 257 (John T. Sanders & Jan Narveson eds., 1996).

6. *Statuta Svo Clauduntur Territorio*.

adequate response to the need to arrange behavior in a world in which physical-geographic location is gradually losing meaning.⁷

Emerging as a parallel trend to globalization, the internal disintegration of the state is a source of counter-pressure, also placing in doubt the suitability of the state law model.⁸

One of the most prominent features of the modern state is its multiculturalism,⁹ a product of the modern era's sophisticated mobility as well as the fact that liberal democratic regimes refrain, as a rule, from coercing cultural assimilation in a state melting pot. The diverse human mosaic that typifies contemporary Western states has led to the widespread phenomenon in which many sectors of the populations fail to share a common value base. Consequently, there is growing ideological alienation towards the state legal system and internal sectoral consolidation.¹⁰

This trend is reflected in the establishment of private alternative legal systems that are tailored to the specific needs of a given community and that distinguish it from other sectors in the state communality.¹¹ One of the most illustrative examples is the private and autonomous legal systems operated by the ultra-orthodox Jewish sector both in the State of Israel and across the world. Within this community, there is widespread resort to private tribunals ("*Batei-Di-Tzedek*"—private courts of justice) to resolve disputes. These tribunals provide a genuine alternative to the general state system. They set behavior norms and settle disputes in the entire range of areas, including matters with a "criminal" slant, with the

7. It is possible to view the problems that arise due to the growth of the Internet as a sort of modern incarnation of the factors that led to the historical consolidation of the "Law Merchant"—namely, the minimization of the territorial dimension of the transactions, the prevalence of one-shot transactions, and the need for speedy and unequivocal decision making. See David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367 (1996); Aron Mefford, Note, *Lex Informatica: Foundations of Law on the Internet*, 5 IND. J. GLOBAL LEGAL STUD. 211, 214 (1997).

8. For a broader review of the challenge to the status of the state law system, see Rex R. Perschbacher & Debra Lyn Bassett, *The End of Law*, 84 B.U. L. REV. 1 (2004).

9. See CHRISTOPHER W. MORRIS, AN ESSAY ON THE MODERN STATE 79 (1998); Erik Luna, *Race, Crime, and Institutional Design*, 66 LAW & CONTEMP. PROBS. 183, 191 (2003); John Rawls, *The Domain of the Political and Overlapping Consensus*, 64 N.Y.U. L. REV. 233, 234 (1989).

10. See JEROLD S. AUERBACH, JUSTICE WITHOUT LAW? 69 (1983); Carrie Menkel-Meadow, *The Trouble with the Adversary System in a Postmodern, Multicultural World*, 38 WM. & MARY L. REV. 5, 29 (1996).

11. See Hanina Ben-Menahem, *Jewish Law and the Constitutional Regime in the State of Israel: Halakha, the State, and the Community Model*, in THE QUEST FOR HALAKHA: INTERDISCIPLINARY PERSPECTIVES ON JEWISH LAW 461, 473 (Amichai Berholz ed., 2003) (Hebrew).

aim of preventing community members from turning to the state courts.¹²

There is an abundance of similar examples of communities that operate closed and internal legal systems, such as the Gypsy community,¹³ the diamond industry community,¹⁴ and the farming community in Shasta County, California,¹⁵ all of which settle community disputes according to a private normative code completely separate and unrelated to any agency of state power. From a slightly different angle, the phenomenon of private communities¹⁶ is also a prominent manifestation of social fragmentation processes and the desire to increase the extent of control wielded by the community while narrowing the central government's power.¹⁷ On the background of these processes of globalization, on the one hand, and the social unraveling within the state's boundaries, on the other, there is growing concern that the state model is standing in the way of more suitable models for ordering social behavior. This makes a reassessment of the state law model imperative.

12. Shlomo Daichovsky, *The Rabbinical Court as Arbitrator*, 16/17 SHNATON HAMISHPAT HAIVRI [YEARBOOK OF JEWISH LAW] 527 (1991); Shlomo Daichovsky, *A Critique of Rabbinical Court Decisions*, 13/14 DINÉ ISR.: AN ANNU. OF JEWISH L.: PAST & PRESENT 7 (1988) (Hebrew).

13. Walter Otto Weyrauch & Maureen Anne Bell, *Autonomous Lawmaking: The Case of the "Gypsies"*, 103 YALE L.J. 323, 325 (1993).

14. Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

15. ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991).

16. See FRED FOLDVARY, *PUBLIC GOODS AND PRIVATE COMMUNITIES: THE MARKET PROVISION OF SOCIAL SERVICES* (1994); EVAN MCKENZIE, *PRIVATOPOLIS: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT* (1994); ROBERT G. NATELSON, *LAW OF PROPERTY OWNERS ASSOCIATIONS* (1989); Donald J. Boudreaux & Randall G. Holcombe, *Government by Contract*, 17 PUB. FIN. Q. 264 (1989).

17. A parallel trend of legislative decentralization is emerging also on the federal plane, manifested in the transfer of legislative powers to the states. For a discussion of the narrowing of the federal legislator's power and the increasing power of the state legislators, see William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201 (1997). There is a clear ideological link between the decentralization of legislation in the federal context and the cancellation of the state's monopoly in law, with the central overlapping point rooted in inter-jurisdictional competition. The ideological basis to this is, amongst other things, Tiebout's classic model of the supply of local public goods. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). Yet despite their similarities, there is a clear distinction to be made between the matter of decentralization of legislation in the federal context and the proposed model for privatizing law: under the federal structure, a legal monopoly is still preserved in any given geographical jurisdiction (even if smaller in scope), whereas the model proposed in this Article rejects the notion of monopolistic law in a given territorial expanse.

II. THE FRAMEWORK OF DISCUSSION

The current legal theory framework lacks, as mentioned, a fundamental discussion of the question of the source of the state's authority to intervene in the law. This vacuum can be explained as deriving from the premise that the institution of state law is justified based on the very justification of the state's existence. In other words, that the economic-philosophical-moral justification for the existence of the state gives rise in itself to the justification for state intervention in legislation and adjudication. Thus, in considering the legitimacy of state intervention in the law, the central grounds justifying the state must be examined. Once these justifications have been formulated, it will be possible to isolate and contend with the components that relate to state intervention in legislation and adjudication.

The purpose of this discussion will be to critique the commonly accepted justifications for the existence of the state and its intervention in the law, on the assumption that undermining the foundations of the approaches that represent the mainstream justification for the state (and, derivatively, its intervention in the law) will tip the balance in favor of detaching the state-law bond. Hence, the discussion will be devoted to challenging the justifications for the state formulated by Hobbes and Locke, the theoretical pioneers of the social contract theory and the fathers of Anglo-American political philosophy.

A. The Hobbesian Justification for State Intervention in the Law

Hobbes (1588–1679) linked the constitution of a state system with the very ability of human society to prevail and exist in peace.¹⁸ He painted a grim and miserable picture of the pre-political condition. Chapter XIII of his book *Leviathan*¹⁹ presents a hypothetical state, commonly known as the “State of Nature,”²⁰ which is characterized by a lack of a sovereign authority²¹ and where the legislative and judicial (and enforcement) functions are in private hands. The first layer of Hobbes's doctrine is the notion

18. JOHN T. SANDERS, *THE ETHICAL ARGUMENT AGAINST GOVERNMENT* 13 (1980).

19. THOMAS HOBBS, *LEVIATHAN* 183 (C.B. MacPherson ed., Penguin Books 1968) (1651).

20. The term “the State of Nature” is not taken from *Leviathan*, but is rather the commonly accepted term used to describe this condition. *See id.* at 40.

21. *Id.*

of a constant threat of “war of all against all”²² in this hypothetical state of nature. This war has harsh outcomes, which lead to social chaos and languish. Human beings, as rational creatures, will come to understand that the solution to the state of nature lies in the pursuit of peace,²³ but at the same time, it will be clear to them that a one-sided laying-down of arms would amount to a death sentence (for them).²⁴ Consequently, under the hypothetical scenario, human beings will choose to exit the state of nature by entering into a social contract, which unifies them under a shared sovereignty. In the framework of this social contract, rational individuals will agree to mutually forego their natural rights to protect their lives by private means. These natural liberties will be transferred to the sovereign, who will, in exchange, provide them with protection and social order. Thus, according to Hobbes, the state is justified in that it is an entity to which rational individuals would have hypothetically covenanted to subject themselves, as a solution to the ills of the state of nature.²⁵ As explained, this Article scrutinizes the justification for state intervention in law, not the general justification for constituting the state. Hobbes explicitly addressed this aspect and defined the sovereign’s role in this context as follows: “He is Judge of what is necessary for Peace; and Judge of Doctrines: He is Sole Legislator; and supreme Judge of Controversies.”²⁶

If this is the case, then the set of claims presented thus far holds the essence of the Hobbesian justification for state intervention in the legislative and judicial functions and the constitution of monocentric state law. Due to the lack of alternative means for successfully imposing peace and social order, rational individuals will be driven to subordinate themselves to the rule of the sovereign and thereby submit to the monolithic set of rules and the monocentric apparatus for dispute resolution that the sovereign sets. For without a state and without monocentric public legislative and judicial mechanisms, social peace will be impossible to achieve and society will be drawn into a never-ending war of all against all. From this hypothetical social contract, Hobbes derives the legitimacy of the state, state law, and the state judicial system.

22. See David B. Suits, *On Hobbes’s Argument for Government*, 4 REASON PAPERS 1, 2 (1978).

23. “The first branch of which Rule, containeth the first, and Fundamentall Law of Nature; which is, *to seek Peace, and follow it.*” HOBBS, *supra* note 19, at 190.

24. SANDERS, *supra* note 18, at 23.

25. It should be stressed that Hobbes does not pin his hopes on an actual social contract in practice, but rather relies on an acceptance in principle of the obligations that arise from an ideological covenant of this sort. See C.B. MacPherson, *Introduction to HOBBS*, *supra* note 19, at 9, 45.

26. HOBBS, *supra* note 19, at 252.

B. *The Lockean Justification for State Intervention in the Law*

One of the most prominent social contract theories following Hobbes was formulated by the English scholar John Locke (1623–1704) in his *Two Treatises of Government*.²⁷ According to Locke, the state of nature, despite its pre-political condition, is not characterized by a legal vacuum.²⁸ Rather, the law of nature reigns, and human beings deduce this law by human reason.²⁹ The Lockean state of nature represents a sort of utopia—a morally ideal state that all human creatures occupy.³⁰ In the framework of this state, human beings enjoy full liberty and equality, in the sense that they are both free of one another and equal to one another.³¹ It is important to stress that this liberty relates to freedom from being harnessed by the Other, to a freedom in social and political relations,³² but not to a freedom from the fetters of the law of nature.³³ According to Locke, under the law of nature, every individual is entrusted with the right to preserve the human race.³⁴ As a consequence of this inherent right to protect the well-being of the human race, each and every person is permitted to act as an “enforcer” of the law of nature,³⁵ both individually and through cooperation with others.³⁶

In light of the existence of the law of nature and the effective ability to execute it, Locke rejected the Hobbesian presumption that the state of nature will inevitably drag human society into a war of all against all. In one of the sole paragraphs in the *Two Treatises of Government* with subtle reference to the Hobbesian argument, Locke stated:

27. JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* (Peter Laslett ed., Cambridge Univ. Press 1988) (1690).

28. BARRY MACLEOD-CULLINANE, *THE RIGHT TO REVOLUTION: TOLERATION, LIBERTY AND THE STATE IN THE THOUGHT OF JOHN LOCKE AND THE EARLY LIBERALS* (1994).

29. “[T]he Law of Nature . . . is the Law of Reason” JOHN LOCKE, *The First Treatise*, in *TWO TREATISES OF GOVERNMENT*, *supra* note 27, ¶ 101; *see also* MACLEOD-CULLINANE, *supra* note 28.

30. *See* David B. Suits, *On Locke’s Argument for Government*, 1 J. LIBERTARIAN STUD. 195, 195 (1977).

31. Peter Laslett, *Introduction to LOCKE*, *supra* note 27.

32. MACLEOD-CULLINANE, *supra* note 28.

33. JOHN LOCKE, *The Second Treatise*, in *TWO TREATISES OF GOVERNMENT*, *supra* note 27, ¶ 6.

34. *Id.* ¶ 8.

35. SANDERS, *supra* note 18, at 30.

36. Locke maintained that the authority to constitute a central government is a metamorphosis of the natural right to unite for the purpose of executing the law of nature. It can be understood from his theory that this right resides alongside the natural right to self-preservation and preservation of the human race. *See* Laslett, *supra* note 31.

And here we have the plain difference between the State of Nature, and the State of War, which however some Men have confounded, are as far distant, as a State of Peace, Good Will, Mutual Assistance, and Preservation, and a State of Enmity, Malice, Violence, and Mutual Destruction are from one another.³⁷

This notwithstanding, Locke asserted that human beings will nonetheless prefer to forfeit their “perfect liberty” in favor of constituting a Commonwealth community and submitting themselves to sovereign rule.³⁸ This will be due to the difficulties in administering justice³⁹ in the state of nature, which destabilize the social order in that state. In situations of non-legitimate uses of force, disputes and wars are likely to erupt.⁴⁰ And once they have begun, they are likely to persist for a long time⁴¹ due to the lack of a neutral greater entity to resolve the discord, and due to the tendency of human beings to tilt the law in their favor—to treat more severely those who have harmed them and with greater lenience their own injuries to others.⁴² Thus a vicious cycle emerges of violation of the law of nature, exaggerated responses to injury, exaggerated responses to exaggerated responses, and on and on.⁴³ Locke reviewed these difficulties entailed in the administration of justice in the state of nature, the first being the legislative failure.

According to Locke, despite the existence of the law of nature, as a practical matter, a shortage of legislation is likely to emerge in the state of nature, due, amongst other things, to biases and failures inherent to the application of the law of nature in concrete circumstances. Locke asserted that, in the state of nature:

First, There wants an establish'd, settled, known Law, received and allowed by common consent to be the Standard of Right and Wrong, and the common measure to decide all Contro-

37. LOCKE, *supra* note 33, ¶ 19 (emphasis omitted).

38. *Id.*

39. See SANDERS, *supra* note 18, at 36.

40. Despite the difficulties identified by Locke as likely to lead to the emergence of violent disputes and the outbreak of wars in the state of nature, his conception is not consistent with the Hobbesian state of nature (or the scenario of a war of all against all). According to Locke, while war becomes a more probable likelihood in the state of nature, it does not describe or define that state. See Laslett, *supra* note 31, at 99.

41. LOCKE, *supra* note 33, ¶ 20.

42. “[I]t is unreasonable for Men to be Judges in their own Cases . . . Self-love will make Men partial to themselves and their Friends. And on the other side . . . Ill Nature, Passion and Revenge will carry them too far in punishing others.” *Id.* ¶ 13; see also Suits, *supra* note 30, at 196.

43. *Id.*

versies between them. For though the Law of Nature be plain and intelligible to all rational Creatures; yet Men being biased by their Interest, as well as ignorant for want of study of it, are not apt to allow of it as a Law binding to them in the application of it to their particular Cases.⁴⁴

The second flaw in the state of nature, identified by Locke, is the judicial failure. This relates to the absence of a neutral institutional third party to which disputes can be directed for resolution in situations of conflicts of interest.

Secondly, In the State of Nature there wants a *known and indifferent Judge*, with Authority to determine all differences according to the established Law. For every one in that state being both Judge and Executioner of the Law of Nature, Men being partial to themselves, Passion and Revenge is very apt to carry them too far, and with too much heat, in their own Cases; as well as negligence, and unconcernedness, to make them too remiss, in other Mens.⁴⁵

The third and final failure is essentially of an enforcement type and is therefore less relevant to the issue under discussion. This failure relates to the absence of an institutional enforcement body in the state of nature for executing judicial decisions.⁴⁶ According to Locke, the problems entailed in administering justice in the state of nature will eventually undermine the overall social order,⁴⁷ and it is at this point that the Lockean doctrine proceeds to the issue of exit from this state. As in the Hobbesian doctrine, Locke's theory presents the social contract as the key to exiting the state of nature.⁴⁸ In the framework of the social contract, the parties covenant to relinquish their natural rights for the purpose of forming a political authority to constitute the state and establish monocentric public systems of legislation, adjudication, and enforcement. The political authority to govern and arrange social behavior constitutes, in this sense, a metamorphosis of the natural rights of all human beings to implement the law of nature and preserve the

44. LOCKE, *supra* note 33, ¶ 124.

45. *Id.* ¶ 125.

46. *Id.* ¶ 126.

47. Albert W. Alschuler, *Mediation with a Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier Trial System in Civil Cases*, 99 HARV. L. REV. 1808, 1810 (1986).

48. Jeffrey Rogers Hummel, Book Review, *Epstein's Takings Doctrine and the Public-Goods Problem*, 65 TEX. L. REV. 1233, 1235 (1987) (reviewing RICHARD EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985)).

human race.⁴⁹ The Lockean justification for forming the state and for its intervention in the law stems from either express or tacit consent of the individuals comprising society to subjugate themselves to the state's rule and to its functional institutions—the public legislative, judicial, and enforcement apparatuses.

In sum, despite the differential starting-points of the two thinkers and despite the fundamental divergences between the Hobbesian social contract and the Lockean variation,⁵⁰ the two doctrines are aimed at a basically identical conclusion: exit from the state of nature is based on entering into a social contract with the purpose of constituting the state and establishing monocentric public legislative and adjudicatory (as well as enforcement⁵¹) institutions.

The conclusions formulated by Hobbes and Locke with regard to the imperativeness of the state and the legitimacy of its intervention in the law were extensively adopted. For hundreds of years, to this very day, there has been sweeping acceptance of their fundamental assertion that state intervention in the law, by establishing state legislative and judicial systems, is indeed justified.

49. Laslett clarifies the following point: in accordance with the Lockean doctrine, the political authority is based on the metamorphosis of human beings' natural rights in relation to others, and thus, the sovereign government should not be understood as derived from the right to self-rule. Laslett, *supra* note 31, at 111.

50. The differences between Hobbes's concept of the social contract and Locke's approach are apparent in the framework of such issues as their respective views of the state of nature, the law of nature, human reason, and the nature of man, as well of the purposes and characteristics of the legitimate state. Locke sketches a softer human nature than that described by Hobbes, as well as painting a far more optimistic picture of the state of nature. In addition, Hobbes sees human reason as a means of extracting man from the state of nature, whereas Locke sees man's rational ability as a means of imposing order within the state of nature. Their concepts of consent also diverge. Locke places greater stress than Hobbes on the element of consent, even though he also extends its application beyond explicit consent. In contrast, in Hobbes's doctrine, consent is ascribed far less overall weight. Hobbes referred to hypothetical and abstract consent and grounded the justification for the state primarily on teleological foundations. An additional difference is rooted in the outcomes of the social contract. Under Hobbes, the social contract cannot be revoked and he grants the sovereign absolute power. The Lockean social contract, in contrast, is revocable and leads to limited government. In this sense, it can be claimed that Locke conceived of a more democratic regime. See also Williamson M. Evers, *Social Contract: A Critique*, 1 J. LIBERTARIAN STUD. 185, 189 (1977).

51. The enforcement element has been intentionally understated as it is irrelevant to the framework of the discussion, as explained at the outset of this Article.

*C. An Analysis of the Components of the Hobbesian
and Lockean Justifications*

Two forms of justification are integrated in Hobbes's and Locke's theories. On the one hand, these justifications rest on a teleological foundation, insofar as they refer to the purposes and aims the state is intended to realize. Both the Lockean and Hobbesian doctrines regard the state as a social instrument for realizing specific goals (first and foremost, the establishment of public legislative, judicial, and enforcement systems⁵²) and rest on the premise that the state is morally justified because it is necessary for realizing these same goals and purposes. On the other hand, Hobbes and Locke grounded their theories also on a constitutive foundation: under both, the state is justified also because of the way in which it is constituted. Thus the state derives its moral legitimacy not only from the purposes it strives to realize, but also from its formation process⁵³ (by way of a social contract).⁵⁴

52. SANDERS, *supra* note 18.

53. It is true that certain reciprocity exists between the teleological and constitutive components. There are grounds to claim that the way in which a social institution is created will impact its substance and purposes. And vice versa—that the goals that the institution will pursue will influence the social willingness to constitute it. Thus, in the present context, it can be asserted that the willingness to enter into a social contract stems from the teleological component and the presumption that the state will aid in achieving goals that cannot be realized in its absence, such as preventing a war of all against all. The opposite can also be stated: it can be argued that a state that is created by means of a social contract can be expected to pursue an agenda that correlates with the objectives at the base of the teleological component. In either case, presumably, there is a direct link between the two spheres. However, a possible alternative conception is that the two layers can in fact be placed at odds. The criticism in this context is that the social contract doctrine suffers from an internal logic contradiction. On the one hand, in order for the teleological component to stand, we must accept the presupposition that human beings will not be willing to cooperate enough in the state of nature for the purpose of maintaining social order. On the other hand, accepting this premise necessarily and inherently entails the negation of any possibility of relying on cooperation for entering into the social contract, on which the constitutive component is based. In other words, if the state is imperative, it is not attainable, and if it is attainable, it is not imperative. The reliance on a social contract for forming the state, on the one hand, and the claim that it is not possible to constitute an effective array of contractual rights in the absence of a state, on the other, amounts, in this context, to a contradiction. See DAVID GAUTHIER, *MORAL DEALING: CONTRACT, ETHICS, AND REASON* (1990); JEAN HAMPTON, *HOBBS AND THE SOCIAL CONTRACT TRADITION* (1986); Tyler Cowen & Gregory Kavka, *The Public Goods Rationale for Government and the Circularity Problem*, 2 *POL., PHIL. & ECON.* 265 (2003); Hummel, *supra* note 48, at 1242; Joseph P. Kalt, *Public Goods and the Theory of Government*, 1 *CATO J.* 565 (1981).

54. It can be claimed that the constitutive component bears lower overall weight in Hobbes's theory than in the Lockean doctrine and vice versa with regard to the teleological element.

This Article will be devoted to attacking the teleological foundations of the two doctrines.⁵⁵ In this framework, I will seek to show that the arguments at the base of these doctrines for constituting a state legal regime are valid and forceful with regard to the need for organized, accepted, and neutral legislative and judicial systems. However, they do not sufficiently justify their complete encompassment under the state umbrella. It is generally possible to take both a positive and negative tack against the teleological foundation. A negative attack challenges the extent to which the state law and the state judicial system can indeed achieve their set goals—that is, such an attack would attempt to show that the state is incapable, both conceptually and concretely, of realizing the goals of providing effective and neutral legislative and judicial systems of the quality and to the extent that enable effective imposition of social order. A positive line of criticism, on the other hand, would attempt to demonstrate that these goals can be realized through private means as well. This Article will seek to formulate a positive attack on the teleological component.⁵⁶ I will attempt to show that legal orders and effective social ordering can be supplied without any recourse to the existing format of state intervention in the law.

55. It is possible to attack the constitutive component in Hobbes's doctrine in a number of aspects. It can be argued that hypothetical consent does not give rise to contractual liability and the fact that rational individuals will tend to agree to some sort of social contract does not bind someone who is not party to the contract in question. See Jonathan Wolff, *Anarchism and Skepticism*, in FOR AND AGAINST THE STATE, *supra* note 3, at 99, 104; Jonathan Wolff, *Hobbes and the Motivations of Social Contract Theory*, 2 INT'L J. PHIL. STUD. 271 (1994).

The constitutive element of Locke's theory also was the target of sharp criticism, with central focus on the different forms of implicit consent. In this context it can be argued that tacit consent does not have sufficient force to serve as an indication of agreement, in cases in which the possibility of exit is most significantly limited. See Jan Clifford Lester, *Market-Anarchy, Liberty and Pluralism*, in FOR AND AGAINST THE STATE, *supra* note 3, at 63; John Dunn, *Consent in the Political Theory of John Locke*, 10 HIST. J. 153 (1967); Iain W. Hampsher-Monk, *Tacit Concept of Consent in Locke's Two Treatises of Government: A Note on Citizens, Travellers, and Patriarchalism*, 40 J. HIST. IDEAS 135 (1979); A. John Simmons, *Tacit Consent and Political Obligation*, 5 PHIL. & PUB. AFF. 275 (1976).

56. An alternative way of interpreting the social contract doctrines, particularly the Lockean version, is that for the teleological objective to be achieved, it is necessary to ensure the establishment of systems that will realize ethical-moral objectives that are derived from the law of nature. In light of such interpretation of the teleological element, it is not sufficient to prove that a private legal order can exist in order to collapse the Lockean justification for state law, and the question of the normative desirability of private legal orders must be contended with as well. This alternative interpretation of the teleological element will be discussed in the framework of a separate paper.

D. The Structure of the Article

The discussion will proceed in the following manner. Part A will be devoted to a preliminary outline of the completely private alternative to the state law model, sketching competitive markets for law in which the means of production involved in supplying legislative and adjudicative services are all privately owned, with the state completely excluded from these functions. On the background of the description of this hypothetical world, I will explain its inherent problems. Namely, I will identify the market failures that arise in the framework of a completely private supply of legislative and judicial services, which presumably mandate state intervention in the law. Part B of this Article will, accordingly, undertake a thorough and systematic review of the range of market failures that are likely to emerge in the described private markets for legislation and adjudication. The discussion will be constructed on a clear distinction between market failures that derive from externalities in the legislative and judicial markets and those failures that stem from the cartelization tendency in the market for law. In the framework of considering failures originating in externalities, I will discuss public goods in the market for law and the network characteristics of the law industry. The discussion on the law market's cartelization tendency will focus on elucidating the claim that, in the long-run, privatization of the market for law will lead to the establishment of an extremely small number of giant suppliers of law, which will be able to abuse their status. After surveying the range of failures that are likely to emerge in the market for law, I will proceed to the final stage of this Article, where I will argue that a monocentric state law is not necessary for overcoming these market failures and that a different, narrower format of state intervention would suffice. I will claim that the existence of market failures, although likely to justify a certain extent of state intervention in the markets for legislation and adjudication, do not justify a state monopoly over these services. Part C of this Article will conclude by outlining an alternative model for providing legislative and judicial services that, on the one hand, is not based on total privatization of the law market and, on the other, loosens the link between the law and the state, in comparison to the Hobbesian and Lockean models of state law.

PART A: A PRIVATE MARKET FOR LAW

With the state law model such an integral part of our surroundings, it is difficult to even conceive of a world in which the state has no foothold in the law. The discussion that follows will therefore be devoted to a most preliminary outline of a fully competitive market for law, with private ownership of all the means of production entailed in supplying legislative and judicial services. At this stage, I will disregard market failures that could arise in a market for law and will assume the existence of a system of competitive legal markets, where entrepreneurship in supplying legal services is completely compensated by the consumer public, aided by accepted copyright mechanisms. A detailed clarification of the market failures involved in private supply will follow in ensuing parts. The scenarios described below are by nature speculative, for there is a fundamental impediment to predicting where initiatives in the legal field will lead.⁵⁷ Moreover, the very consideration of such enterprises or attempt to foresee precisely the way in which a private market for law will unfold would emerge as a doubled-edged sword for the privatization model, for a most compelling argument in favor of centralization could be made were we to possess the rational ability to amass and process the thousands upon thousands of extensive pieces of information required to depict exactly how the competitive market is expected to operate.⁵⁸ Accordingly, no pretense will be made here of providing a full and hermetic response to the question of how private markets for legislation and adjudication will function. The discussion will have a more modest aim, namely, concretization of the concept of "privatization of legislation and adjudication" and providing a general

57. Part of the problem is the concern that there will be a certain allegiance to the existing model and adherence to a state "mindset." In this respect, the attempt to examine how legal systems that fundamentally resemble the state system can be supplied in a free market is likely to emerge as redundant. Privatizing the law and altering the public dimension of the legal systems may lead to a complete transformation of their general character. It is possible that in the private framework, there will be greater reliance on dispute-resolution mechanisms (such as mediation procedures), rather than dispute-determination mechanisms (such as arbitration). It is also possible that the nature of the dispute-deciding procedures will diverge from the accepted format; one of any number of complex and creative solutions may be, for example, greater reliance on referees than on judges. In light of the limited ability to disconnect from what already exists and estimate how the change to the public dimension of such a dynamic system as the legal system is likely to impact its other aspects, I will limit my analysis to the dispute-deciding mechanisms that imitate the public judicial system. An additional reason to focus specifically on private judicial mechanisms, which resemble in substance the state judicial system, stems from the challenge it entails: it is specifically these mechanisms that can be expected to be more problematic to supply in a competitive market.

58. See John Hasnas, *The Myth of the Rule of Law*, 1995 WIS. L. REV. 199, 228.

idea as to the ramifications of transforming the state law model into a “privatized” legal system.

One keystone in constructing a conception of a competitive market for law is the empiric experience that has amassed with regard to private legislative and judicial systems, such as the customary legal system in the Shasta County farming community in California⁵⁹ and the merchant groups in the diamond⁶⁰ and cotton⁶¹ industries. There are a number of central motifs common to all of them: the establishment of standard and accepted procedures for determining disputes, evolutionary processes of customary law, recognition of individual rights while placing emphasis on property rights, a prominent tort dimension and the predominance of monetary remedies, social sanctions such as boycotting and ostracization, and victim responsibility for execution of the law, supported and assisted by institutional reciprocal arrangements.⁶² This empiric evidence is likely to shed some light on the possible evolution of the law within the structure of a competitive market. One probable (albeit not necessary) prospect is that some of these fundamental features will exist in legal systems that arise with the privatization of the market for law.

The private model for the supply of legislative and judicial services rests on an array of competing legal orders that, as a conglomerate, order social behavior—that is, a polycentric set of “legal communities” that coexist within one geopolitical unit. I will first consider the privatization of the legislative function. In a competitive market for legislation, each legal community will be able to institute a separate and unique legislative order. Some of the legislative agencies might prohibit abortions while others may not; some may make writing a constitutive requirement for contracts, whereas others may suffice with a verbal contract in all areas. Some law agencies may offer all-inclusive legal regimes, while others may restrict themselves to more specific and narrow spheres of social ordering.

Legislative services will be consumed similarly to how other economic goods and services (such as entertainment, health, clothing, and footwear) are currently consumed. Every individual will have the ability to choose the legal system that suits his or her preferences and a maximal degree of control in choosing the legal basket to which he or she will be subject. The ability to provide distinct

59. ELLICKSON, *supra* note 15, at 1315.

60. Bernstein, *supra* note 14.

61. Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001).

62. BENSON, *supra* note 4, at 21.

legal products will mean that the needs of many sub-markets can be responded to simultaneously. In this context, it is important to recall that human beings are complex and multi-dimensional creatures. They may have conservative tendencies with regard to certain aspects of ordering human behavior (for example, with regard to euthanasia), yet at the same time be liberal with regard to other aspects (for example, with regard to abortion). Under the state law structure, there is little room for maneuvering.⁶³ In contrast, under the private model, it will be possible to unpack the various social ordering dimensions in light of which people will be able to order their behavior. They will have the option of assembling a legal basket that more precisely reflects all components of their personalities and of creating the closest representation of their vast array of preferences. They will be able to consume some of the legislative services of an agent with a liberal inclination, while ordering another part of their behavior and legal relations by way of a conservative agent.

Like their discrete contents, the normative origins of the legal regimes that will prevail in a competitive legal market for law can also be expected to be diversified, deriving from customary, precedential, or contractual foundations. A rough distinction can be drawn in this context between the two models of a private law market likely to arise as alternatives to state law. The one model, the decentralist model, would rest on an array of spontaneous customary law systems; that is, on private legal orders that gradually emerge and evolve, whose development is not a product of conscious design, and that have innumerable untraceable sources. The second model would be the polycentric model, founded on legal regimes whose creation is initiated by private, perhaps even for-profit, legislative bodies.⁶⁴ This private law would be the product of

63. Moreover, under the state model, a move from one legal system to another (from state to state) entails heavy costs. See David Hume, *Of the Original Contract*, in *SOCIAL CONTRACT: ESSAYS BY LOCKE, HUME, AND ROUSSEAU* 147, 156–59 (Ernest Baker ed., 2d ed. 1960).

64. It should be noted that, from the perspective of terminology, the distinction I draw between the concepts “polycentric legal structure” and “decentralist structure” does not reflect the use of these terms by other authors. This terminological division is not even consistent with the original intention of Polanyi, the scholar who apparently coined the term “polycentric.” In using the term “polycentric,” Polanyi was in fact seeking to describe a spontaneous and uninitiated social order. See MICHAEL POLANYI, *THE LOGIC OF LIBERTY: REFLECTIONS AND REJOINDERS* 170 (1951). The term “polycentric” was “imported” into the jurisprudence discourse by Hayek, who also was referring to a spontaneous and uninitiated legal order. See RANDY E. BARNETT, *THE STRUCTURE OF LIBERTY: JUSTICE AND THE RULE OF LAW* 257 n.1 (1998); F. A. HAYEK, *THE CONSTITUTION OF LIBERTY* 160 (1960). In addition, there are scholars who make use of the terminology “polycentric system” with regard to both

a planned and institutional initiative, entering the world only after undergoing an orderly development procedure and with traceable sources.⁶⁵

The lion's share of the literature on non-state private law has focused thus far on spontaneous customary law. Many view it as "the" natural alternative to state law.⁶⁶ This Article, however, will attempt to illuminate the alternative of a polycentric legal system that is based on private legislative and judicial bodies that operate for profit in a competitive market. This choice stems, first and foremost, from the fact that the needs of modern society (like the technological means available to it) make the complex alternative of an instituted legislative enterprise, in the framework of the private sector, into a more probable option. Admittedly, it is difficult to predict where privatization of the legal system will lead and it should be assumed that two types of law—customary law and law created by a planned legislative initiative—will be present in the conglomerate of the private market for law; however, in the modern era, the particular weight of the institutionalized private alternative can be expected to be greater. The focus on the polycentric model derives also from research considerations, from the desire to shed some light on an angle of private law that has yet to enjoy any thorough consideration in the literature. This notwithstanding, since there is great similarity between the models and both alternatives deal with a multiplicity of competing sources of law and the supply of legislative services in the private sector, the discussion of the polycentric model can be drawn on for insight into the customary alternative.

The network of relations that will emerge between the private suppliers of law in a polycentric legal market will essentially resemble the relations amongst states acting in the international arena. Choice of law rules will be established to arrange "border-crossing" interactions between individuals belonging to different legal agencies. Law agencies will function both as "manufacturers" of legal rules and as the mediators of social covenants.

The privatization process will also impact the material contents of the legislative products. In this context, it can be expected that emphasis will shift from the political-public dimension of the law to the private dimension. The sharpest transformation can be

customary law and private law that is the product of a planned initiative. See, e.g., Lester, *supra* note 55, at 63, 71.

65. See ELLICKSON, *supra* note 15; Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338 (1997).

66. See, e.g., ROBERT SUGDEN, *THE ECONOMICS OF RIGHTS, CO-OPERATION AND WELFARE* (1986).

expected on the “criminal law” plane, a sphere that is nourished by the state-law link. In the framework of a private market for law, criminal law can be expected to be absorbed into tort law; the state’s status in criminal procedure will be eliminated⁶⁷ and the “criminal offense” will be treated essentially like an intentional tort against the victim,⁶⁸ with a focus on compensating the victim.⁶⁹ Another probable outcome of the shift in emphasis to the private dimension is the reduced probability of any normative arrangement covering “victimless crimes,” such as gambling or soft drug use.⁷⁰ In the framework of a private market for law, restriction of individual freedom of action will be limited, in all probability, only to behaviors involving an identified victim.

Similar to the market for legislation, abolishing state intervention in the market for adjudication and dispute determination will lead to the emergence of a polycentric regime of competing suppliers of judicial services that operate alongside one another within one geopolitical unit. In a competitive adjudicatory market, it will be possible to offer different models of judicial procedures. Certain judicial bodies will likely place greater emphasis on legal certainty or strict formalistic rules in the judicial procedure; other private tribunals might focus on the aspect of speediness or boast procedural flexibility. We can expect tribunals seeking to determine disputes, as well as judicial bodies seeking consensual resolutions. Certain judicial bodies are likely to specialize in narrow areas of dispute and to offer professional services to a defined clientele, while some agencies will appeal to a broader public, offering judicial services in a whole spectrum of areas and disputes.

In the conditions of a competitive judicial market, fairness and neutrality of private judges will be ensured by an internal control mechanism founded on the completely voluntary nature of the appeal to the private tribunals. A private court that conducts itself in a prejudiced fashion will not survive over time. Once it acquires a dubious reputation, it will fail to win the confidence of potential litigators. External entities will refrain from entering into legal relations with the agency’s customers for fear of being subject to its biased adjudication, and consequently, disputes involving external

67. MURRAY R. ROTHBARD, *THE ETHICS OF LIBERTY* 85 (1982).

68. BENSON, *supra* note 4, at 351.

69. Despite the fact that damages will almost certainly be the central remedy in a polycentric legal structure, there is nothing in principle to prevent other remedies. For example, Benson points to the fact that under customary legal systems, such as that which prevailed in Ancient Iceland, offenders in particularly severe cases were even sentenced to death. For more details, see *id.* at 356.

70. *Id.* at 351.

parties will not be brought before the agency. It will be relegated to disputes involving only its own customers as parties; moreover, if it emerges as systematically prejudiced against one particular side in such disputes as well, the consistently biased sector of its customers will also become alienated. The volume of disputes brought to the agency for determination will slowly shrink, and it will eventually go out of business.⁷¹

An inevitable question relating to the functioning of a private judicial market is how disputes will be settled between customers of different legal agencies applying discrete legal regimes. This is most pertinent in the context of random disputes that arise in the absence of any pre-dispute relationship between the parties, as in the case of a car accident between two strangers. Presumably, the solutions provided by the market for such arbitrary disputes will rest on the involvement of third parties in the network of relations between the parties to the dispute: on each party's ongoing relations with third parties and on the reciprocal relations between those third parties. Thus, for example, any individual in the market can belong to any one of the legislative and judicial service-providers, which concurrently serve as a sort of insurance company for that individual in instances in which he or she has acted in accordance with the agency's criteria but has, nonetheless, become embroiled in a dispute. The individuals in the market will be induced to belong to legal agencies, for otherwise people will refrain from engaging in legal relations with them. An additional incentive, as mentioned, will derive from people's ability to collect directly from an agency in cases of behavior that conforms to the agency's legal rules. Of course, functionally, it will be possible to substitute the legal agencies with actual insurance companies or credit companies, which operate on a similar system of incentives; when a dispute arises, each party will apply to his or her agency. Due to the ongoing network of relations that are highly likely to develop amongst these agencies—which will be small in amount relative to the size of the general population—they will bear the characteristics of repeat players and, as such, will have incentives to cooperate with one another. Any agency that acquires a negative reputation for impeding and undermining the dispute-resolution processes will likely be ostracized by the competing agencies. The ramifications will be borne by its customers, for customers of other agencies will refrain from contracting with them. The customers of the ostracized agency will then be compelled to switch to accepted

71. David Osterfeld, *Anarchism and the Public Goods Issue: Law, Courts, and the Police*, 9 J. LIBERTARIAN STUD. 47, 57 (1989).

agencies that are recognized by their competitors.⁷² Due to the ongoing network of relations, in the majority of cases the agencies will arrange amongst themselves the way in which disputes between their customers will be determined and the applicable choice of law rules, in either a pre-dispute (*ex-ante*) contractual agreement or a post-dispute (*ex-post*) contractual agreement. A more prominent option in a long list of possible solutions would be to refer the dispute to be determined by a third, neutral agency. On many levels, there will be great resemblance to the currently prevailing practice in the framework of disputes in the private international sphere.⁷³

This preliminary outline describes competitive markets for legislation and adjudication. There is room, however, to dispute its underlying premise, that privatization would indeed lead to a competitive market for law. At this juncture, I will proceed to a discussion of the market failures that are likely to arise in private markets for legislation and adjudication, which can be divided into two principal types. The first category of market failures stems

72. Support for the prediction regarding the settlement of disputes between law agencies by peaceful means can be found in the clear predisposition of insurance companies to settle disputes amongst themselves outside the courtroom. Empirical evidence shows that an extremely high rate of disputes between insurance companies are settled outside of the court room. See David Friedman, *Anarchy and Efficient Law*, in FOR AND AGAINST THE STATE, *supra* note 3, at 235. Of course, there is room to maintain that the comparison is problematic, for peaceful resolution amongst insurance companies is the result of the existence of a functioning legal system in whose shadow such negotiations are conducted. This point will be further discussed in following parts of this Article, relating to market failures in the market for law.

73. The minimization of the failures inherent to random interaction through reliance on reputation ties and third-party feedback is not a novel phenomenon. There are many examples of this practice throughout history, in which the investment in reputation served as a guarantee against defection, including in multilateral contexts. Already in the eleventh and twelfth centuries, merchant groups would map out potential partners, who many times lived on the other side of the Mediterranean Sea, relying on information received through an exchange of letters. In the present era, technological developments have led to a significantly sophisticated ability to amass and disseminate information. This has considerably increased the ability to make use of reputation mechanisms to neutralize the problematic incentives that accompany one-shot interactions. The most prominent application of the improved technology for storing and spreading information and for reputation-building has arisen in the framework of the Internet. Its virtual trading forums serve as the foundations for constructing effective apparatuses for gathering and dispensing information regarding third-parties' previous contractual activity, as in the case of eBay.com, Yahoo.com, Half.com, Cnet.com, and Amazon.com. Modern technology, especially in the communications field, has turned the entire world into a "global village." It has redefined and given new meaning to the term "community" and has enabled the significant expansion of the term to apply in an almost unlimited fashion. This is due to the fact that the dizzying technological developments of the last generations have been used to overcome geographic gaps. In the past, these gaps were obstacles to efficient distribution of information and chances of reciprocal interactions. Today, modern technology enables us to easily skip over these hurdles, facilitating mutual monitoring and flow of information—even in the framework of the largest, most heterogenic, and dispersed of societies.

from the existence of externalities in the markets for legislation and adjudication and relates to the “public good” and “network industry” features of law. The second category of market failures is related to the cartelization tendency in the private market for law.

PART B: MARKET FAILURES IN THE MARKET FOR LAW

I. EXTERNALITIES

A. *Public Goods*

During the almost two centuries since Adam Smith formulated his free market economy theory, categories of exceptions have been defined in which economic efficiency cannot be achieved by the market forces alone—the most prominent exception being the public good.⁷⁴ As is well known, a pure public good is distinguished by two critical characteristics: non-rivalry and in-excludability. The first feature relates to the fact that its consumption by one consumer does not detract from the ability of others to consume it. A public good can simultaneously appear in the utility functions of numerous individuals.⁷⁵ The second characteristic touches on the inability (or unfeasibility from an economic perspective) to allocate property rights in this good and to prevent it from being consumed by someone who did not participate in its funding.⁷⁶ The central problem with the supply of a public good in the framework of a competitive market stems, of course, from the free-rider phenomenon. Since it is not possible to allocate to each individual in the market the ability to consume the public good in correlation with his or her investment, a rational utility maximizer will prefer not to voluntarily participate in supplying the good. And when there is a free-riding response from a mass of individuals in the market regarding the public good, a market failure arises. Despite being vital for the common welfare, the attempt to supply the good

74. The focus on the study of the public good first began with the publication of Paul Samuelson's research work, which became the canon of classic economic theory. This field developed rapidly, and today public economics is a central school in the study of economics. See Paul A. Samuelson, *Diagrammatic Exposition of a Theory of Public Expenditure*, 37 *REV. ECON. & STAT.* 350 (1955); Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 *REV. ECON. & STAT.* 387 (1954).

75. ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 40 (2d ed. 1997).

76. See WILLIAM J. BAUMOL & ALAN S. BLINDER, *ECONOMICS: PRINCIPLES AND POLICY* 639 (4th ed. 1988).

in a competitive market will fail,⁷⁷ with the probable outcome that either the good will not be supplied at all on the private market or else, in a milder variation of the market failure, there will be sub-optimal supply.⁷⁸ State intervention, of course, enables this free-riding based failure to be overcome. As a rule, the need for state intervention in the supply of public goods is strongest with regard to first-order public goods—those public goods that are regarded as an indispensable condition for the very existence of an economic market, and are vital for obtaining other public goods (second-order goods).⁷⁹ This understanding emerges also from Hobbes's doctrine discussed earlier:⁸⁰ as demonstrated, according to Hobbes, the elements that comprise a social regime (legislative, judicial, and enforcement systems) feature the characteristics of such first-order public goods and, in any case, cannot be supplied adequately in a free-market framework.⁸¹ I will now turn to discuss the qualities that distinguish the law as a public good both with regard to the judicial function and to the legislative function (including judicial lawmaking).

1. The Public Good Aspects of Adjudication

The judicial function bears prominent private features,⁸² in that the determination of a dispute generates private utility for both parties to the dispute.⁸³ However, alongside this private utility are also public utilities to adjudication of the dispute: the very constitution of a system for peacefully resolving disputes in society⁸⁴ and the very appeal to that system have characteristics of public goods.⁸⁵

77. MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 35 (1971).

78. See Mark Bagnoli & Michael McKee, *Voluntary Contribution Games: Efficient Private Provision of Public Goods*, 29 *ECON. INQUIRY* 351, 352 (1991); Gerald Marwell & Ruth E. Ames, *Economists Free Ride, Does Anyone Else? Experiments on the Provision of Public Goods*, 15 *J. PUB. ECON.* 295, 296 (1981).

79. See MORRIS, *supra* note 9, at 59.

80. MICHAEL TAYLOR, *THE POSSIBILITY OF COOPERATION* 1 (1987).

81. Howard H. Harriott, *Games, Anarchy, and the Nonnecessity of the State*, in *FOR AND AGAINST THE STATE*, *supra* note 3, at 119.

82. See William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 *J. LEGAL STUD.* 235 (1979).

83. *Id.* at 240. It is important to distinguish, in this context, between determining the dispute and creating judicial precedent.

84. See Alschuler, *supra* note 47, at 1813.

85. Anthony de Jasay, *Self-Contradictory Contractarianism*, in *FOR AND AGAINST THE STATE*, *supra* note 3, at 137, 150; David Luban, *Essay, Settlements and the Erosion of the Public Realm*, 83 *GEO. L.J.* 2619, 2622–26 (1995); Lawrence B. Solum, *Alternative Court Structures in the Future of the California Judiciary: 2020 Vision*, 66 *S. CAL. L. REV.* 2121, 2172 (1993).

When two parties consume private judicial services in order to resolve the dispute between them by peaceful means, the fruits of the peace that prevails between them are reaped also by third parties.⁸⁶ Resolving disputes without resort to force fosters social peace and stability. The dispute-determining function promotes social peace not only in ending the enmity between the two parties to the actual dispute, but also, in a broader fashion, by creating a general deterrence effect.⁸⁷ Bringing rights-violators to justice actually deters potential injurers from acting similarly,⁸⁸ the outcome being a general prevention of harms and disputes. Other public goods associated with the judicial procedure emanate from its expressive function: the judicial verdict is likely to serve as a means of conveying a message of moral condemnation⁸⁹ as well as caution to the public⁹⁰—for example, warning against someone who has been convicted of a sexual offence.

The concern that arises is that under a competitive legal market structure, potential litigators will not internalize in their utility function this range of social utilities, which are embodied in the very bringing of a suit and the bringing to justice of someone who has violated their rights. Due to the free-riding tendency, each individual in the market will rely on others to supply peace, deterrence, or information and will not be willing to bear the costs of supplying these “public” components of the judicial procedure. The outcome will be sub-optimal consumption of judicial proceedings for determining disputes and sub-optimal supply of the public goods that accompany the judicial function—peace, deterrence, and information.⁹¹

The failure to internalize the social utility generated by the judicial procedure is also likely to be manifested in the remedy sought by private litigators who opt for judicial proceedings against someone who violated their rights due, for example, to the private utility they can expect to reap. To illustrate, take a dispute over intentional

86. Morriss, *supra* note 4, at 582.

87. For an extensive discussion of the enforcement counterpart to this phenomenon, see EPSTEIN, *supra* note 48, at 5; A. Mitchell Polinsky, *Private Versus Public Enforcement of Fines*, 9 J. LEGAL STUD. 105 (1980).

88. MORRIS, *supra* note 9, at 66; Alschuler, *supra* note 47, at 1813.

89. Dan M. Kahan, *The Secret Ambition of Deterrence*, 113 HARV. L. REV. 413, 419 (1999); Erik Lillquist, *Recasting Reasonable Doubt: Decision Theory and the Virtues of Variability*, 36 U.C. DAVIS L. REV. 85, 137 (2002); Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021 (1996).

90. See Samuel Bray, Comment, *Not Proven: Introducing a Third Verdict*, 72 U. CHI. L. REV. 1299, 1308 (2005).

91. Susan Rose-Ackerman & Mark Geistfeld, *The Divergence Between Social and Private Incentives to Sue: A Comment on Shavell, Menell, and Kaplow*, 16 J. LEGAL STUD. 483, 483 (1987).

bodily harm that arises in the framework of a competitive market for law. When the victim, rather than the state, conducts proceedings against the injurer, she may weigh only her own narrow private utility from the judicial procedure, with the remedy she seeks related only to realizing that utility. The public interest in placing the offender behind bars, for example, for the purpose of preventing prospective criminality will not be represented in the victim's set of considerations.⁹² The victim is likely to give preference to a high damages award over imprisonment.

Alongside the non-internalization of the positive externalities in the area of deterrence and prevention, a parallel problem of negative externalities and shifting undesirable behavior to third parties is also likely to arise within the structure of a competitive market for dispute determination.⁹³ For example, the resolution in the framework of a private determination of a dispute between *A* and *B* over environmental pollution might actually include a component of shifting pollution to the external parties *C* and *D*, who are not represented in the proceedings.⁹⁴ In other words, state intervention in the market for dispute determination is vital, it may be claimed, not only due to the under-supply of public goods entailed by the judicial function, but also due to the non-internalization of negative externalities—and the fear of causing public bads.

2. The Public Good Aspects of Legislation (including judicial lawmaking)

The legal rule is considered a classic public good.⁹⁵ The allocation of contract and property rights constitutes an imperative condition for the framework of human existence⁹⁶ and the

92. Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1201 (1985). At the same time, of course, the judicial procedure encompasses private utility in the sense of diverting future crime away from the victim.

93. See Alon Harel, *Efficiency and Fairness in Criminal Law: The Case for a Criminal Law Principle of Comparative Fault*, 82 CAL. L. REV. 1181, 1195 n.41 (1994). Here, the discussion is conducted in the framework of a slightly different context: the privatization of protection against crime and the attendant externalities. This notwithstanding, the analogy is clear. See also Luban, *supra* note 85, at 2626.

94. See Friedman, *supra* note 72, at 235, 244–45; David Luban, *The Quality of Justice*, 66 DENV. U. L. REV. 381, 404 (1989).

95. See KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 23 (1974); JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY* 108 (1975); RODNEY H. MABRY ET AL., *NAT'L INST. L. ENFORCEMENT & CRIM. JUST., AN ECONOMIC INVESTIGATION OF STATE AND LOCAL JUDICIARY SERVICES* 78 (1977); Jules Coleman & Charles Silver, *Justice in Settlements*, 4 SOC. PHIL. & POL'Y 102 (1986); Landes & Posner, *supra* note 82, at 235.

96. JOHN HOSPERS, *LIBERTARIANISM: A POLITICAL PHILOSOPHY FOR TOMORROW* 425 (1971).

functioning of an economic market.⁹⁷ The legal rule is vital for guiding social behavior;⁹⁸ it enables individuals to plan their steps in a timely fashion,⁹⁹ to make an informed assessment as to how others can be expected to conduct themselves, and to negotiate in the shadow of the law.¹⁰⁰ The law lowers transaction costs in the economy,¹⁰¹ assists in the *ex-ante* prevention of disputes, and in their *ex-post* resolution. In addition to guiding social behavior, the legislative procedure and legal product serve expressive and educational roles.¹⁰² The law acts as an arena for elucidating social values and for elevating certain perceptions of justice from amongst alternative views,¹⁰³ while the legislative procedure is a platform for democratic deliberation.¹⁰⁴

Law features the defining characteristic of non-rivalry: from the moment a body of legislation is enacted, an unlimited number of individuals can make use of that legal corpus and derive from it the entire diversity of attendant utilities. The marginal cost of supplying the legal rule to an additional consumer is zero.¹⁰⁵ The “consumption” of any legal rule by one individual does not detract from the ability of other individuals to consume it simultaneously; the fact that a certain individual shapes his or her behavior in accordance with a legal rule does not detract, in itself, from the ability of others to act similarly.¹⁰⁶ The quality of in-excludability is also present in the law. The very belonging to the relevant social framework enables one to derive utility from the existence of the legal corpus that applies in that framework.¹⁰⁷ It is not possible to grant copyright in a legal rule or to prevent someone without

97. JAMES C. SCOTT, SEEING LIKE A STATE: HOW CERTAIN SCHEMES TO IMPROVE THE HUMAN CONDITION HAVE FAILED 351 (1998).

98. See Linda A. Schwartzstein, *An Austrian Economic View of Legal Process*, 55 OHIO ST. L.J. 1049, 1068 (1994).

99. JOSEPH RAZ, ETHICS IN THE PUBLIC DOMAIN: ESSAYS IN THE MORALITY OF LAW AND POLITICS 355 (1994).

100. The originators of the term “bargaining in the shadow of the law” are Mnookin and Kornhausert, in their article Robert H. Mnookin & Lewis Kornhausert, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979).

101. Gordon Tullock, *The Logic of the Law*, in Anthony T. Kronman & Richard A. Posner, *THE ECONOMICS OF CONTRACT LAW* 22 (1979).

102. See Marc Galanter & Mia Cahill, “Most Cases Settle”: *Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 1339, 1382 (1994); Steven D. Smith, *Reductionism in Legal Thought*, 91 COLUM. L. REV. 68, 71 (1991).

103. See, e.g., Edward F. McClennen, *Moral Rules as Public Goods*, 9 BUS. ETHICS Q. 103, 104 (1999).

104. Gerald B.H. Solomon & Donald R. Wolfensberger, *The Decline of Deliberative Democracy in the House and Proposals for Reform*, 31 HARV. J. ON LEGIS. 321, 323 (1994).

105. John R. Haring & Kathleen B. Levitz, *The Law and Economics of Federalism in Telecommunications*, 41 FED. COMM. L.J. 261, 285 n.43 (1989).

106. Solum, *supra* note 85, at 2176.

107. MABRY ET AL., *supra* note 95, at 80; Morriss, *supra* note 4, at 581.

property rights in that rule to act in accordance with its prescriptions.¹⁰⁸ Moreover, in-excludability manifests in the legal rule in both its aspects: not only is there no practical way of withholding the fruits of legislation from someone who did not participate in supplying it, but the economic feasibility of so doing is doubtful.¹⁰⁹ The power of the legal rule is anchored in its collective application. Ability to unilaterally cease to be subject to the legal rule is not desirable, and any attempt to limit the consumption of the legal rule solely to those who have participated in its funding would be directly at odds with its very essence as a tool for guiding social behavior.¹¹⁰ Due to its nature as a public good, the law will be supplied below the social optimum within the structure of a competitive market. Thus, for example, as a product of the in-excludability of legal rights and the lack of an effective mechanism for granting copyright in them, entrepreneurs in the legislative field who bear the costs of producing the law will not be able to reap the entire utility entailed by the legislative enterprise.¹¹¹ From the moment that it sees the light of day, the legal rule they have articulated will become accessible to all of society, without any possibility of instituting an effective mechanism to compensate entrepreneurs for the development process. In light of this, individuals in a competitive legislation market will refrain from allocating enough resources to the development of the law and will be incentivized to free-ride on the lawmaking efforts of others.¹¹²

108. *But cf.* William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249 (1976). The purpose of the model presented in the framework of this article was to examine the extent of optimal investment in "production" of legal precedents as well as to examine the desirable pace of investment in them, as a function of the capital invested, the rate of depreciation, and the relevance of the interaction between these factors. In the margins of this model, the authors related to a certain allocation of "copyright" in the legal precedent, but the proposal that they put forth in this context is problematic and leaves many irresolvable vacuums.

109. MABRY ET AL., *supra* note 95, at 80.

110. JAMES M. BUCHANAN, *THE BASES FOR COLLECTIVE ACTION 2* (1971).

111. The flawed incentive for legislative initiative is likely to be exacerbated in private markets in which the supply of legislative services is intertwined with the supply of judicial services. Landes and Posner maintain that in a competitive market for adjudication, the exposure of the rules at the foundation of the judicial verdict is likely to guide potential litigators with regard to the line the particular private judge will take in similar cases in the future, thereby deterring (at least one of the sides) from litigating before that judge. Due to the need to attract future customers, judges in the private sector are likely, therefore, to refrain from judicial lawmaking and to instead wrap a cloak of ambiguity around the normative considerations that guide them in their decisions. *See* Landes & Posner, *supra* note 82, at 239-40.

112. *See* Clayton P. Gillette, *Rules, Standards, and Precautions in Payment Systems*, 82 VA. L. REV. 181, 217 (1996). The problematic nature of initiatives in the framework of a competitive market for legislation also arises in the federal context:

Optimal development of the law will be possible, consequently, only based on non-market motivations and incentives, which exist in the framework of the public system.¹¹³

Alongside the non-internalization of the positive social utility, there is concern also regarding negative externalities that arise in the market for legislation: the legal rule that is formulated between *A* and *B* might generate negative externalities for a third party and divert undesirable behaviors to him. As shown above in the discussion of the judicial function, and in the legislative context as well, there is difficulty ensuring the internalization of these negative externalities without government intervention.¹¹⁴

Due to the public characteristics of the law, the market may fail to ensure its optimal supply, despite the fact that it is vital for ordering social behavior and for the general welfare.¹¹⁵ This is the foundation of the justification for state intervention in the markets for legislation and adjudication. Further validation of the need for state intervention stems from the very nature of these services. The very existence of the economic market is contingent on the allocation of contractual and property rights;¹¹⁶ since these rights constitute a precondition for the formation of an economic market, the entire conceptualization of market supply of these legal rights can be challenged.¹¹⁷ That is to say, if the law must precede the market in order for the market to exist, the law cannot originate from the market itself. The public nature of the legislative and judicial systems and the functional dependence on them for the existence of an economic market necessitate, therefore, the supply of these services by mechanisms that are external to the market

Essentially, the risks of innovative laws are borne asymmetrically: the benefits of successful legal innovations are shared with non-innovating, free-riding states, whereas the consequences of failed innovation (sunk research and development costs, migration of constituents out of the jurisdiction, and diminished reputation and goodwill) are shouldered by the innovating state alone.

Ronald J. Daniels, *Should Provinces Compete? The Case for a Competitive Corporate Law Market*, 36 MCGILL L.J. 130, 149 (1991).

113. Geraldine Szott Moohr, *Arbitration and the Goals of Employment Discrimination Law*, 56 WASH. & LEE L. REV. 395, 436 (1999).

114. See generally ARTHUR CECIL PIGOU, *THE ECONOMICS OF WELFARE* (Transaction Publishers 2002) (1952).

115. See RICHARD A. POSNER, *THE FEDERAL COURTS: CRISIS AND REFORM* 10 (2d ed. 1996); Edward J. Brunet, *A Study in the Allocation of Scarce Judicial Resources: The Efficiency of Federal Intervention Criteria*, 12 GA. L. REV. 701, 706 (1978); Osterfeld, *supra* note 71, at 48.

116. Language and currency are additional public goods that can be deemed preconditions to the existence of the market. See SCOTT, *supra* note 97, at 351.

117. DANIEL BELL, *THE CULTURAL CONTRADICTIONS OF CAPITALISM* (1976).

(i.e., the state).¹¹⁸ For this reason, the spiritual forefathers of the capitalist school of thought posited that the legal system must be supplied by the state. Even those same economists who waved the banner of laissez-faire (led by Adam Smith¹¹⁹) at the same time stood firm in their stance that the state must intervene in the supply of law and adjudication.¹²⁰

B. Law as a Network Industry

Beyond the public goods that are entailed by the law industry, unique market failures arise, which are related to its network characteristics. The term “network industry” refers to the wide range of industries and goods for which there are demand-side benefits to scale.¹²¹ The utility that each consumer derives from consuming a network good positively correlates with the number of additional consumers of the good (and in some instances also the extent of their overall consumption).¹²² The demand for a network good is a function both of the price of the good and the size of the network. As a rough generalization, network industries can be categorized as those industries whose goal is to serve as a platform for interaction between consumers and that feature characteristics that enable their consumers to share information, electronic signals, and standards.¹²³ A good illustration is the telephone network: the owner of the sole telephone in the world can derive zero utility from it. In the absence of other consumers of the telephone, he has no ability to make effective use of his instrument for communicating with others. The more common and prevailing telephones become, the greater the utility each telephone owner can derive from his in-

118. Osterfeld, *supra* note 71, at 48.

119. 2 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (Richard D. Irwin, Inc. 1963) (1776).

120. RICHARD CORNES & TODD SANDLER, *THE THEORY OF EXTERNALITIES, PUBLIC GOODS, AND CLUB GOODS* 3 (2d ed. 1996); Landes & Posner, *supra* note 82, at 235.

121. S.J. Liebowitz & Stephen E. Margolis, *Network Effects and Externalities*, in 2 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 671 (Peter Newman ed., 1998); Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 *J. ECON. PERSP.* 93 (1994); Michael L. Katz & Carl Shapiro, *Network Externalities, Competition and Compatibility*, 75 *AM. ECON. REV.* 424 (1985); William J. Kolasky, *Network Effects: A Contrarian View*, 7 *GEO. MASON L. REV.* 577, 579 (1999).

122. An additional parameter might be the identity of the consumers. See David A. Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition*, 7 *GEO. MASON L. REV.* 523, 524 (1999).

123. Howard H. Chang et al., *Some Economic Principles for Guiding Antitrust Policy Towards Joint Ventures*, 1998 *COLUM. BUS. L. REV.* 223, 236.

strument.¹²⁴ This positive correlation between the economic value of the good and the number of its consumers (and their overall consumption) characterizes, in addition to technological and electromagnetic communications networks, also amorphous communications networks, such as language and the law. Thus, in order to derive utility from the acquisition of a language or from subjection to a legal system, there must be parallel use by others. The very constitution of the law as a tool for guiding social behavior and deciding disputes is contingent on this. For without a critical mass of individuals who are willing to submit to accepted codes of behavior and dispute-determination mechanisms, it is not possible to order social behavior by way of these rules and mechanisms.¹²⁵ The greater the scope of the legal network and its number of members, the more far-reaching the potential legal interactions between those members will be.¹²⁶ Accordingly, the law, by nature, is based on network effects and constitutes a network industry.¹²⁷

The competition between networks features characteristics that differ in substance from the competition that evolves between standard goods. These characteristics raise two types of difficulties in supplying the network goods within the structure of a decentralized market. The first problem touches on under-standardization or over-divergence in law.¹²⁸ Each consumer who joins the network increases the utility derived by the rest of the individuals consuming the network good or service, in that he expands its effective size. His actual consumption generates positive utility for the other consumers of the network. This social utility, however, is extrinsic

124. Mark A. Lemley, *The Law and Economics of Internet Norms*, 73 CHI.-KENT L. REV. 1257, 1281 (1998).

125. Thus, for example, the incentive for investing the resources involved in writing a literary work will typically exist only if the lion's share of the public submits to the legal rule that grants the author intellectual property protection for his work. Recognition of the copyrights of authors by only a small part of the population will usually be of negligible significance. Of course, "critical mass" has differential size, and must be considered on a case-by-case basis. In certain contractual contexts, it is sufficient that only two individuals agree to a common set of standards; in other contexts, the threshold will be far higher numerically. See generally THOMAS C. SCHELLING, *MICROMOTIVES AND MACROBEHAVIOR* (1978) (discussing "critical mass").

126. Clayton P. Gillette, *Harmony and Stasis in Trade Usages for International Sales*, 39 VA. J. INT'L L. 707, 723 (1999); Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. REV. 813, 833 (1998).

127. One example of this is traffic laws: the greater the proportion of drivers who subject themselves to the accepted signal of the "red light" and its ensuing outcomes, the greater the utility derived from its application and its actual use. See Avery Katz, *Taking Private Ordering Seriously*, 144 U. PA. L. REV. 1745, 1750 (1996).

128. See Pierre Regibeau, *Defending the Concept of Network Externalities: A Discussion of Leibowitz and Margolis*, 17 RES. IN L. & ECON. 33, 35 (1995).

to his own utility function.¹²⁹ The ensuing outcome is likely to be the establishment of legal networks whose scope is sub-optimal.

The second concern relates to legal lock-in and over convergence in law: the network gets locked into a sub-optimal standard. The claim is that in a decentralized market structure, even if the market forces lead to the application of uniform standards, there is still a danger of inefficient standards being set or standards becoming inefficient over time. Thus, in the legal market, there is likely to be a negative incentive for the private legal bodies to detach themselves from the dominant legal standard, even if in favor of a preferable legal standard, since unilateral detachment means forfeiting the utility derived from belonging to the existing legal network. The private utility embodied in belonging to the network creates, therefore, a negative incentive for legislative initiative, with the concern being that in a decentralized legal market we will witness the collective application of inefficient legal rules. The next Part of the discussion will be devoted to clarifying each of these phenomena.¹³⁰

1. The Problem of Under-Standardization

Privatizing the legal system paves way for the emergence of a multitude of legal systems within a given geopolitical unit, and the accelerated development of differential legal rules.¹³¹ The number of legal systems that will evolve under a private law model might well exceed the number of law agencies, for each agency can sup-

129. Philip H. Dybvig & Chester S. Spatt, *Adoption Externalities as Public Goods*, 20 J. PUB. ECON. 231, 231 (1983).

130. At a further point in the discussion, I expand on the potential ramifications of the network structure for the danger of cartelization in a private market for law.

131. Cover's theory expresses the view that private law systems create "too much law," to the point where inconsistency and instability in guiding social behavior result. Robert M. Cover, *Foreword, Nomos and Narrative*, 97 HARV. L. REV. 4, 41 (1983). According to Cover, the role of the state law system is not to produce legal norms, but rather to sift out and choose one dominant norm from the abundance of private norms that comprise the "nomos." In this respect, he echoes the notion that in the absence of state intervention, standardization cannot be achieved in the norm market and the application of a uniform law is possible only with the invalidation of competing norms and erection of one of them as the prevailing legal rule. He states:

It is remarkable that in myth and history the origin of and justification for a court is rarely understood to be the need for law. Rather, it is understood to be the need to suppress law, to choose between two or more laws, to impose upon laws a hierarchy. It is the multiplicity of laws, the fecundity of the jurisgenerative principle, that creates the problem to which the court and the state are the solution.

ply any number of parallel normative frameworks.¹³² The potential for diversification is even broader in light of the fact that individuals will be able to consume a number of legal systems simultaneously; that is, they will be able to order their relations with their neighbors under law regime *A*, their relations with their work colleagues under *B*, their behavior vis-à-vis other drivers on the road according to the standards of legal system *C*, and so on and so forth. In principle, due to the ability (of the individual consumer) to consume a number of normative systems concurrently and the ability (of each individual supplier) to supply an unlimited number of legal systems, there is vast potential for normative diversity in the framework of the polycentric legal structure.¹³³ But hovering at the doorstep is the danger of legal cacophony: an overabundance of incompatible legal systems and networks, to the point where the substance of the law is likely to be stripped of content as an instrument for guiding social behavior. Here lies the basis for the need for government intervention.¹³⁴ Moreover, in a private law regime comprised of a great number of small law networks, the different law suppliers are likely to be incentivized to legislate laws with negative external effects for the members of competing networks.¹³⁵ As a result of the regulatory diversity and on the background of the potential for a vast amount of parallel law networks, their ability to cooperate in preventing the described diversionary effect is severely hampered.¹³⁶

This depiction can, however, be softened somewhat by qualifying the ramifications of the described market failure in two important respects. First, the private utility entailed in belonging to a network must be taken into account. This utility precludes the materialization of the extreme scenario of infinite fragmentation of the state law into tiny law networks upon privatization of the law. Second, it is necessary to consider things on the background of the state model: state law, by nature, is tainted with a parallel failure. Due to its link to territorial-state boundaries and the notion of legal monolithism in a given state unit, the state law suffers from over-standardization in some cases and under-standardization in others. It can be claimed that it is in fact the network features of the law

132. Friedman, *supra* note 72, at 235.

133. Hasnas, *supra* note 58, at 229.

134. For an expanded discussion on the sub-optimal standardization phenomenon in network industries, see Jeffrey Church & Neil Gandal, *Network Effects, Software Provision and Standardization*, 40 J. INDUS. ECON. 85 (1992).

135. Nim Razook, *Uniform Private Laws, National Conference of Commissioners for Uniform State Laws Signaling and Federal Preemption*, 38 AM. BUS. L.J. 41, 46 n.20 (2000).

136. Note, *To Form a More Perfect Union?: Federalism and Informal Interstate Cooperation*, 102 HARV. L. REV. 842, 844-46 (1989).

that serve to justify, even partially, instituting a polycentric legal order.¹³⁷ I will relate in brief to each of these points.

In light of the network features characterizing the law industry, private law suppliers can increase the utility their customers derive from consuming their law services by coordinating with competing law suppliers. Such coordination would enable the consumers of the individual law supplier to enjoy the benefits of scale, as though the consumers of competing suppliers are clients of their own supplier. The private utility garnered from belonging to a dominant legal network creates an inherent incentive for law suppliers to provide network-conforming legal rules—with shared basic features—and for the clients to consume those rules. Moreover, since the network structure creates mutual dependence amongst competing legislative and judicial service-suppliers,¹³⁸ the sanction of ejection from the network (due to cooperation evasion) is a most effective dangling sword. For indeed, attempting to supply network services or goods outside the network fundamentally alters their nature and quality.¹³⁹

Accordingly, it is reasonable to assume that even in the absence of any central governmental planning, the network effects will create an incentive for standardization, at least in all that regards the hard core of the law: namely, those dimensions of human behavior ordering that are vital for imposing minimal social order, such as rules against murder, assault, rape, and theft.¹⁴⁰ The normative fragmentation amongst the different law entities, if it occurs, can be expected to relate to the more marginal derivatives of social behavior ordering, such as euthanasia or abortion. This resembles the current divergences amongst different state legal systems. Standardization will be attainable also through a splitting of the applicability of legal orders into inter- and intra-agency contexts; with such division, the law suppliers will be able to offer their target clientele a high degree of conformity with competing law suppliers and, at the same time, unique services and specific legal rules that respond to the distinct needs within agency borders.¹⁴¹

Support for the assessment that the market forces will lead to the adoption and application of an essentially standardized norma-

137. See BENSON, *supra* note 4, at 300.

138. For a parallel discussion on the telephonic field, see Balto, *supra* note 122, at 524.

139. See Bryan Caplan & Edward Stringham, *Networks, Law, and the Paradox of Cooperation*, 16 REV. AUSTRIAN ECON. 309 (2003); Tyler Cowen, *Law as a Public Good: The Economics of Anarchy*, 8 ECON. & PHIL. 249, 259 (1992).

140. BENSON, *supra* note 4, at 352.

141. An analogous example of the split between internal interactions and external interactions can be found also in private credit institutions and the banking world. See Edward Stringham, *Market Chosen Law*, 14 J. LIBERTARIAN STUD. 53, 70 (1999).

tive base, even in the absence of central governmental planning, can be drawn from what occurs in other network industries, such as the technological field. Take, for example, the market for facsimile machines. One uniform standard for all fax machines is followed across the globe; all faxes operate in accordance with this shared standard, which enables intercommunication. This standard crystallized in a competitive market, without any government intervention.¹⁴² The same is true with regard to networks in banking, credit, computers, and the Internet,¹⁴³ as well as the QWERTY standard for the order of letters on keyboards.¹⁴⁴ The prediction that standard legal rules will emerge in a polycentric market is also supported by the historic experience that has amassed in relation to the market for law itself:¹⁴⁵ the mercantile law that evolved across Europe consolidated privately and, from a random collection of normative systems, crystallized gradually into a coherent and coordinated legal system.¹⁴⁶

Claiming that the structure of the law necessitates standardization cannot necessarily justify government monopolization in this field.¹⁴⁷ Standardization, albeit partial or sub-optimal, can form also in market conditions, for, given an identical set of considerations, every consumer will prefer to consume a good that is compatible with the network over a good that deviates from that standard. However, sometimes the sets of considerations are not uniform, and in many cases, a supplier or consumer of the law will actually derive considerable utility from deviating from the prevalent legal standard. But this is precisely the point: the monolithic law approach is not necessarily the most efficient one. The application of one uniform law is not desirable in all circumstances.¹⁴⁸ The claim that the legal rule market has a certain innate bias towards

142. See Katz & Shapiro, *supra* note 121, at 434.

143. See David S. Evans & Richard Schmalensee, *A Guide to the Antitrust Economics of Networks*, 10 ANTITRUST 36, 37 (1996).

144. S.J. Leibowitz & Stephen E. Margolis, *The Fable of the Keys*, 33 J.L. & ECON. 1 (1990).

145. Another example is the international law sphere. Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and the Decline of the Nation State*, 18 CARDOZO L. REV. 925 (1996).

146. HAROLD J. BERMAN, *LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION* (1983).

147. This is evidenced by the fact that human society succeeds in functioning and ordering legal relations, including amongst citizens of different states, despite the absence of one shared global government. See NARVESON, *supra* note 4, at 221; MURRAY N. ROTHBARD, *POWER AND MARKET: GOVERNMENT AND THE ECONOMY* 4 (2d ed. 1977).

148. Take, for example, the inherently problematic nature of applying a uniform law in matters concerning marriage and family law. On the background of the split in values and ideology in this area between the different sectors in society, applying a uniform law is likely to emerge as undesirable.

standardization does not necessitate the conclusion that full and absolute standardization is desirable in this area.¹⁴⁹ Government intervention and normative uniformity bear economic costs. The *a priori* approach of uniform law in fact fundamentally precludes the legal product's suitability to distinct consumer preferences of the individuals subject to that law. In certain instances, this conception is likely to constitute an obstacle to attaining efficiency.¹⁵⁰

It is important to stress that the equilibrium between convergence and divergence that will emerge in market conditions will not be optimal, since the consumer in the private structure may not internalize the social utility of belonging to a network. But this does not negate the claim that this sub-optimal equilibrium is preferable to the equilibrium point that arises currently under the state law model. Thus, in the state framework, the monolithic legal order that applies in a given geographic area is arbitrarily established in accordance with territorial-state boundaries. These boundaries constitute, at most, the historic remnants of geopolitical developments. The arbitrariness of the territorial parameters and monolithic status of the state law within those parameters are an impediment to achieving legal diversity in the internal state context. The state law model is an obstacle also in the context of the formation of a legal network that transcends state boundaries,¹⁵¹ it hinders contending with cross-border social phenomena,¹⁵² something that is most prominently manifested in the field of international trade.¹⁵³ In a private market structure, in contrast, there would be no such random and arbitrary dichotomy based on state borders. In this respect, the private model facilitates diversification not only in the law's content but also in its general configuration: a competitive structure can be expected to stimulate prosperous legal networks of varying scopes and sizes. In some of the law's branches (as in the case of *lex mercatoria*), the functional size of the legal network can be expected to exceed the territorial-state borders of our time. In other branches of the law (marriage

149. See Saul Levmore, *Variety and Uniformity in the Treatment of the Good-Faith Purchaser*, 16 J. LEGAL STUD. 43 (1987).

150. Bruce H. Kobayaski & Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company*, 34 ECON. INQUIRY 464, 469-70 (1996).

151. See Michael I. Krauss, *Regulation vs. Markets in the Development of Standards*, 3 S. CAL. INTERDISC. L.J. 781, 798 (1994).

152. The phenomenon of the crystallization of normative standards that transcend state boundaries is gaining impetus despite the obstacle of state law. However, the state structure increases the transaction costs entailed in this process. Moreover, in other areas, such as criminal law, the state structure prevents completely standardization of this type.

153. See John O. McGinnis, *The Decline of the Western Nation State and the Rise of the Regime of International Federalism*, 18 CARDOZO L. REV. 903 (1996).

and divorce), the networks can be expected to be narrower in scope relative to that of today's state entities. And in yet other instances, a certain overlap can be expected in the size of the network that will emerge in the framework of a competitive market and the scope of the state law.¹⁵⁴

2. The Problem of Legal Lock-in

The efficiency of the private system is not a matter only of whether or not it will be possible to institute a uniform legal regime. Rather, it is a broader issue that relates also to the content of the uniform legal standard that will be established, if at all. In this context, I will point to an additional failure, that of over convergence: namely the lock-in that is likely to arise in a private market for law due to the network characteristics of this industry.¹⁵⁵ The lock-in phenomenon occurs whenever a certain standard that was adopted in the framework of a network industry (in its capacity as the first standard adopted in the market or based on a set of conditions that have since disappeared) becomes less suitable. However, since it is the prevailing standard, there is incentive for the agencies that comprise the network to adhere to it so that they can continue to reap the utility of belonging to an established and large network (i.e., path dependence). One of the most cited examples in the literature relates to the perseverance of the "QWERTY" standard for keyboards.¹⁵⁶ It is claimed that this standard is less efficient than alternative standards (such as the "DVORAK" standard) and actually slows down typing. Yet despite the recognition of the inefficiency of the QWERTY standard, there has been no move to deviate from it, due to coordination costs and the utility that members derive from belonging to the "QWERTY network."¹⁵⁷

This may also be the case with regard to the law network: in market conditions, the private legal entities may refrain from shifting to new and preferable legal regimes, since unilateral detachment from the existing legal network would amount to a forfeiting of the private utility inherent to belonging to the

154. BENSON, *supra* note 4, at 300.

155. Gillette, *supra* note 112; see also Abhijit V. Banerjee, *A Simple Model of Herd Behavior*, 107 Q.J. ECON. 797 (1992); Sushil Bikhchandani et al., *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. POL. ECON. 992 (1992); Cass R. Sunstein, *Social Norms and Social Rules*, 96 COLUM. L. REV. 903 (1996).

156. Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332 (1985).

157. *Id.* at 334–35.

network. In a decentralized structure, the private law suppliers and consumers will likely fail to internalize the social utility entailed in the adoption of efficient legal rules and may prefer instead less efficient rules, so as not to exit the “legal network.”¹⁵⁸ Due to the private utility of belonging to the prevailing legal network and the coordination costs entailed in consolidating a critical mass of consumers who will be willing to transfer to an alternative legal regime, a negative incentive arises for legislative enterprise. This faulty incentive system is likely to lead to legal stagnation—to collective adherence to the inferior legal regime and resistance to a coordinated shift from the status quo to the more efficient legal standard.¹⁵⁹ Accordingly, one of the sharpest points of criticism that can be levied against privatizing the market for law is that the state structure might actually ensure a richer platform for legal development and is likely to generate, at the end of the day, legal rules that do not stagnate, since the centralization inherent to the state law enables a coordinated shift to preferable legal standards.¹⁶⁰

However, in this context as well the picture is not necessarily so harsh. In many cases, the direct network effects do not stem from the utility of the aggregate consumption of the entire body of network members, but rather from that of a certain group of those members. The transaction costs of the shift to a sophisticated standard for such sub-groups are lower than the costs entailed in a shift by all of the network consumers, turning a coordinated move into a probable likelihood. In the context of the law, there are a considerable number of areas of social ordering in which the reciprocal relations arise mainly between small and defined groups. In these instances, there is a viable possibility of negotiations between the entities that comprise the different sub-groups for the purpose of a coordinated move to preferable legal standards and internalization of the externalities inherent to the lock-in phenomenon.

Indeed, from the historical perspective, we see development and entrepreneurship in law, despite the network characteristics of this industry.¹⁶¹ The private legal systems, such as the Law Merchant (*lex*

158. It should be noted that the normative lock-in phenomenon is not unique to the private legal model. There is a not inconsiderable amount of normative locking-in in the state law framework as well; this is the very function performed, by definition, by the binding legal precedent. However, in the state model, there are accelerated channels of development, such as the framework of statutory legislation.

159. Katz, *supra* note 127, at 1750.

160. Gillette, *supra* note 126, at 821.

161. Stan J. Liebowitz & Stephen E. Margolis, *Path Dependence*, in 1 ENCYCLOPEDIA OF LAW AND ECONOMICS: THE HISTORY AND METHODOLOGY OF LAW AND ECONOMICS 981, 995 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

mercatoria), had considerable flexibility and evolved at a fast pace.¹⁶² The same is true with regard to the evolution of social institutions such as language, religion, and social norms and etiquette. These mechanisms evolve and flourish, even without government interference and despite their network dimension.¹⁶³

II. CARTELIZATION TENDENCIES

The discussion to this point has focused on failures that stem from the existence of externalities in the markets for legislation and adjudication. An additional market failure results from the fact that the law manifests features of a natural monopoly. The concern is that privatizing the law will lead to the establishment of a “private” monopoly in the market for social ordering. An alternative variation of this prototype of market failure relates to the emergence of cartels in the market for law—to the formation of a small number of giant entities for supplying legislative and judicial services that can cooperate and exploit their aggregate power to cause injury to the consuming public.¹⁶⁴

A. Nozick’s Model

Professor Nozick’s model,¹⁶⁵ set forth in his book *Anarchy, State and Utopia*,¹⁶⁶ will serve as the departure point for the discussion of the monopolization tendency in the market for law. Nozick’s

162. Bruce L. Benson, *Legal Evolution in Primitive Societies*, 144 J. INSTITUTIONAL & THEORETICAL ECON. 772 (1988).

163. Of course, there are many cases of government intervention in these institutions. For example, in many places across the world, there is no separation of state and religion. Many states foster “official languages” and promote their development by means of such entities as academies of language or subsidization of the study and instruction of the language in state schools and universities. I merely claim that it is possible to invoke any number of examples, historical and current, of the development of the institutions of language, religion, and currency without any government intervention.

164. Daniels, *supra* note 112, at 147–48 (“Anti-competitive activity in the case of legislation production may take the form of a collusive agreement among governments to refrain from legislative innovation in an effort to maintain stable market shares.”).

165. The issue of monopolization in the market for protection embodies a narrow aspect of Nozick’s theory. Nozick sought to examine the legitimacy of the minimal state and arrived at the general conclusion that it is rooted in the state’s evolution from Dominant Protection Agencies. He considered whether a society founded on the Lockean state of nature will remain in a state of anarchy. His conclusion was that the move to the minimal state will occur automatically without impairment to the natural rights of any person. This process serves as the basis for Nozick’s justification of the existence of the minimal state and its moral legitimacy.

166. ROBERT NOZICK, *ANARCHY, STATE, AND UTOPIA* (1974).

propositions were directed primarily against the enforcement function, but can be derivatively applied also to privatization of the judicial and legislative functions. Nozick asserted that there are benefits to scale in the supply of protection services,¹⁶⁷ due to which a competitive market for social ordering will not be sufficiently stable. According to Nozick, at the end of the day, the market forces will lead to the emergence of a "Dominant Protection Agency" ("DPA"), which will have a monopolistic status in the given territorial realm. The reason for this is rooted in the fact that the quality of the protection services offered by each agency will derive from its relative size in the market and will be contingent on the quality of the protection services supplied by competing agencies.¹⁶⁸ Unlike other goods with differential value, claimed Nozick, in the case of protection services and social ordering, there is no possibility of evenly balanced competition amongst competing suppliers.¹⁶⁹ Due to the need for a determination in favor of one or the other, agencies of equal power will not be able to coexist; indeed, in this situation, violent clashes amongst them are to be expected.¹⁷⁰ Moreover, according to Nozick, the power discrepancies amongst the agencies can be expected to reproduce themselves: the value of an agency that supplies protection services of a sub-maximal quality will drop disproportionately with the growth in the number of consumers of the agency that supplies maximal protection services. The very existence of a gap between the protection agencies impairs the quality of the services that the weaker agency can supply and enhances the quality of the services the stronger agency can supply. This serves as the basis for the continued growth of the strong agency and the decline of the weaker one. And in any event, claimed Nozick, the life expectancy of weak agencies is short.¹⁷¹

The starting point for Nozick is the Lockean state of nature. According to Nozick, in the majority of cases, the social peace and order will be preserved. However, from time to time, violations of individuals' rights will occur, whether inadvertently or intentionally. In response to this, voluntary associations for the purpose of protection are likely to form, which will be able to make use of their aggregate power and (shared) strong arm to fight the battle of the innocent victim. Business entrepreneurs can be expected to identify the profit potential of this process and to offer protection

167. See GREGORY S. KAVKA, *HOBBSIAN MORAL AND POLITICAL THEORY* 172 (1986).

168. Osterfeld, *supra* note 71, at 60.

169. MORRIS, *supra* note 9, at 68–69.

170. NOZICK, *supra* note 166, at 16.

171. *Id.* at 17.

services for a fee. In the state of nature, therefore, organizations offering protection services are likely to arise—Protective Associations (“PAs”). Of course, at the preliminary stage, many protection agencies will operate concurrently and the consumer will be able to choose from amongst them, as well as belong to a number of PAs simultaneously. And yet, in light of the benefit to scale in the market for protection and the fact that the actual size of the protection agency impacts directly on the quality of the services it can supply, Nozick proposed three possible scenarios of inter-agency disputes. The first is the persistence of a war between two protection agencies until one emerges victor. In such a situation, the customers of the losing agency will join the winning agency. The former will go bankrupt and will exit the market, while the latter will intensify its power. The second possibility is that, in order to improve its situation and chances of winning, each of the agencies will concentrate its power in one relatively limited geographic area. Each agency will then establish itself as the dominant agency in the realm in which it is concentrated and will enjoy preferential status relative to its rival. The final possibility is an effective balance between the two agencies. According to Nozick, in this situation, the agencies will be incentivized to cooperate and subject themselves to a supra-apparatus for deciding the dispute between them, in order to avoid the enormous expenses entailed in conducting an unending war, which would shrink their profit share. Nozick maintained that all three outcomes will lead, with time, to the effective establishment of a Dominant Protection Agency in a given geographic area. This will be the result either of the amassment of power by one agency and removal of all of its competitors from the market or else of the formation of a confederation of agencies that unite under one shared organizational roof to establish a Dominant Protection Agency. The DPA is considered by Nozick to be the prototype state.¹⁷²

172. There are fundamental differences between the DPA and the minimal state. Thus, from a formal perspective, no one is forced to belong to the DPA. Every individual is entitled to protect his property and life by himself. At the same time, the DPA is not obligated to protect non-members. In the described sense, the DPA embodies a de facto monopoly in the supply of law and enforcement services, in contrast to the de jure monopoly that characterizes the state. At later stages of his discussion, Nozick turns to an examination of the shift from the ultra-minimal state to the minimal state, which runs a coercive monopoly in its territory. See NOZICK, *supra* note 166, at 23.

B. Cowen's Model

Professor Tyler Cowen's cartel model¹⁷³ can be set alongside Nozick's model of the monopoly in the market for law. Cowen's conception is grounded, to a large extent, on Nozick's theory, in its reference to the evolutionary progression from the Lockean state of nature to the ultra-minimal state. There is also a fundamental similarity to the basic gist of their discussions: both Nozick and Cowen raise the possibility of private protection agencies formulating agreements to settle disputes between them peacefully. As a result, both predict the emergence, with time, of a monolithic law and enforcement order in a given geographic space. However, whereas Nozick stresses the tendency towards monopolization in the market for law, Cowen's underlying fundamental claim is that cooperation in the market for law and protection will foster cartel-like behavior.¹⁷⁴ According to Cowen, it is not an inevitability that one legal agency will predominate; rather, even in a situation of a multiplicity of agencies, the necessity to cooperate with competing agencies in order to survive financially and the need to create a network of inter-agency contractual relations and arrangements will impel the separate agencies to operate as a cartel.¹⁷⁵

Cowen's doctrine connects to the previous parts of the discussion in this Article with regard to the network characteristics of the law (and protection) industry. As argued there, the network structure of the law industry results in mutual dependency amongst competing law suppliers.¹⁷⁶ The private law suppliers are driven to cooperate (even minimally) in order to persevere as businesses: supplying law services outside of the network changes the character and quality of the services so fundamentally that it is likely to amount to a death sentence for the departing agency. Accordingly, the legislation and adjudication entities must adapt themselves to the legal network's prevailing standards and institute a framework for arranging disputes amongst them. This is in contrast to industries dealing with standard goods or services, where there is no need for such cooperation amongst competitors. It is the interdependence amongst competing law suppliers which gives rise to the fear of cartelization in the market for law. The ramification of the described cooperation, according to Cowen, is the neutralization

173. Tyler Cowen & Daniel Sutter, *The Costs of Cooperation*, 12 REV. AUSTRIAN ECON. 161 (1999); Cowen, *supra* note 139; Tyler Cowen, Comment, *Rejoinder to David Friedman on the Economics of Anarchy*, 10 ECON. & PHIL. 329 (1994).

174. For additional differences, see MORRIS, *supra* note 9, at 70.

175. Cowen, *supra* note 139, at 259.

176. *Id.*

of the competitive element of the market for social ordering. Per Cowen, the very ability to settle disputes between competing agencies by peaceful means is an indication of the resistance of these industries to the forces that, in regular circumstances, curb cartelization. If the private law agencies succeed in uniting to formulate inter-agency covenants and choice of law rules, they will be able to use this cooperation as a platform for creating trade restraints and preventing new participants from entering the market. As derived from Cowen's theory, at the base of those very same characteristics and abilities that enable the law and protection agencies to avoid a Hobbesian war of all against all lies their power to operate a cartel in the markets for social ordering.

In general, then, Cowen can be read as follows: the very ability to overcome the first category of market failures in the private market for law (supply of the public goods encompassed in the law and protection industry) paves the way to the market failure of the second type (the cartelization tendency in the markets for protection and law).¹⁷⁷ According to Cowen, there are only two possible outcomes to the privatization of the markets for legislation and adjudication: anarchy in the Hobbesian sense (the collapse of these markets, i.e., a perpetual state of war of all against all)¹⁷⁸ or mutual cooperation amongst law and protection suppliers, which will lead, in the long-run, to non-competitive cartels in the market for social ordering.¹⁷⁹ Under the second constellation, all of the advantages of privatizing the law will go to waste: the consumers of the law services will be exposed to a drastic decline in the quality of the legal services offered, to a sharp increase in the cost of these services, and, in general, to exploitation by the law and social ordering agencies.¹⁸⁰ Cowen's and Nozick's stances are presumably supported by the empiric experience regarding the practical and ideological triumph of state law and its institutions;¹⁸¹ indeed,

177. The mirror image of this logic failure constitutes sharp criticism against the social contract theories. As explained at the outset of this Article, under the Hobbesian conception, governmental coercion is a condition for the supply of public goods—first and foremost, the public good of peace/social order. And yet it is possible to regard the very act of uniting for the purpose of formulating a social covenant and for constituting the state as a type of public good in itself. See *supra* note 53.

178. Caplan & Stringham, *supra* note 139.

179. See Daniels, *supra* note 112, at 147; Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 517 (1998).

180. Cowen, *supra* note 139, at 261.

181. MORRIS, *supra* note 9, at 98.

human society started out in a state of anarchy and today it is comprised of a multitude of states and state law.¹⁸²

INTERIM SUMMARY

The discussion thus far has been devoted to a consideration of the question of whether the law—in all its functional institutions—can evolve in a state of nature and in the absence of government support. As I sought to demonstrate, privatization in the markets for legislation and adjudication may result in two types of market failures: failures that stem from the existence of externalities in the judicial and legislative markets and failures originating in the cartelization tendency. However, in order to make a definitive determination with regard to how legislative and judicial services should be supplied, it is not sufficient to merely point to the existence of such market failures. Rather, it is necessary to compare between the flaws entailed in the private supply of these services and the problems that arise in the framework of public supply. It cannot be *a priori* assumed that the state necessarily functions more efficiently in situations in which the private market fails, or that it can fix the failures of the market at zero cost.¹⁸³ Much of the criticism that is raised against private supply of services or goods suffers from a basic bias in favor of the state alternative, due to an asymmetric comparison between utopian public models and realistic private models.¹⁸⁴ This asymmetric comparison stands also at the foundation of Hobbes's and Locke's doctrines, each of whom dwelled on the flaws in the supply of social ordering in the state of nature, without conducting an insightful inquiry into the flaws likely to arise in the alternative state framework. State intervention comes at a cost, and the public supply of legislation and adjudicatory services is not free of flaws. I will not vastly expand on this point (for it is a negative attack on the social contract theories, as opposed to the positive tack taken by this Article) and will only

182. For a discussion of the historical developments that led to the establishment of the Western states, see BERMAN, *supra* note 146. A possible response to this empiric criticism is that the state law model could well be a necessary stopover on the way to the polycentric legal model, in light of its crucial importance for the allocation of primary resources and rights. But this model must not be seen as the necessary end station. In this respect, the polycentric model is likely to be suited not to pre-state-law times but to the post-state-law period.

183. See JOSEPH E. STIGLITZ, *ECONOMICS OF THE PUBLIC SECTOR* 88 (3d ed. 2000).

184. Demsetz termed this approach "the nirvana approach." Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969).

raise a small number of points to elucidate the matter, beginning with state legislation.

Inherent to the state legislative system are the same failures of under-incentive to become efficient that characterize all public-sector bodies. Under the state model, the incentive system is not strong enough to drive legislators to enact efficient or quality laws. Their salaries and professional advancement are not directly dependent on the degree of utility generated by the legislative products they generate. Despite the fact that legislators are subject to public scrutiny due to the need to be reelected each term, they are not directly subject to the market forces.¹⁸⁵ Moreover, as proven by the public choice literature, it is precisely this need to succeed in future elections that incentivizes state legislators to enter into agreements with interest groups to pass sectoral legislation, which promotes a narrow agenda at the expense of the public at large and the aggregate social utility.¹⁸⁶ Thus, under public choice theory, the state legislation processes are channeled to the good of powerful sectors and narrow interest groups, at the expense of the general public interest.¹⁸⁷ The public legislation is “sold” to the highest bidder by legislators, in exchange for electoral and financial support, and “bought” by interest groups.¹⁸⁸ These groups seek to push the state legislator in the direction of legislation that suits their set of preferences, towards protecting regulation in areas in which the existing arrangement promotes their interests¹⁸⁹ or towards preventing regulation in other areas.¹⁹⁰ The central factor that impacts an interest group’s “buying power”¹⁹¹ is not the quantitative variable (i.e., its numeric size), but rather the force of its interests and degree of its concentration. Small and concentrated interest groups, with a higher interest per capita, will generally be more effective in attaining benefits in the area of legislation than

185. Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?*, 9 J. LEGAL STUD. 593 (1980).

186. Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 906 (1987).

187. Hummel, *supra* note 48, at 1241.

188. William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875, 877 (1975).

189. Sidney A. Shapiro, *Keeping the Baby and Throwing Out the Bathwater: Justice Breyer's Critique of Regulation*, 8 ADMIN. L.J. AM. U. 721, 722 (1995).

190. Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101, 102 (1987).

191. The use of the concept “buying power” is qualified, of course, by the recognition of the fact that, in the political context, it is not possible to convert money for votes on a one-for-one basis.

large and dispersed interest groups, like the public at large.¹⁹² This stems, primarily, from the costs of collective action and association,¹⁹³ which increase more rapidly than the growth of the group in size.¹⁹⁴ An additional factor in this context touches on homogeneity of the group's set of interests. The more homogeneous the potential group, the lower the collective action costs, and, in any event, groups that unite around a narrow set of interests wield a prominent advantage over the general public.¹⁹⁵ The state law model is therefore likely to produce legislative products that are biased in favor of the narrow interests of strong, concentrated segments of society, all at the expense of the aggregate social welfare.¹⁹⁶

Non-exposure to the market forces impairs not only the incentive to legislate efficient laws but also the effective ability to do so. The mechanism for the transfer of information between elected public representatives and the state's citizenry is immeasurably more ambiguous and limited than the signals provided by the market forces and the pricing mechanism in the private sector.¹⁹⁷ In this sense, state legislation can be analogized to central economic planning,¹⁹⁸ under which decisions are made by a small number of decision-makers who are shown only isolated segments of the overall information picture.¹⁹⁹ The dispersed character of the information necessary for choosing efficient laws, which derives from how each individual behaves in the market, precludes any ability on the part of the central authority to accumulate this information and process it into an efficient legislative planning

192. Donald A. Dripps, *Criminal Procedure, Footnote Four, and the Theory of Public Choice; Or, Why Don't Legislatures Give a Damn About the Rights of the Accused?*, 44 SYRACUSE L. REV. 1079, 1080 (1993).

193. Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7, 16 (2000).

194. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

195. BENSON, *supra* note 4, at 90. *But cf.* George J. Stigler, *Free Riders and Collective Action: An Appendix to Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 359 (1974).

196. MICHAEL T. HAYES, *LOBBYISTS AND LEGISLATORS: A THEORY OF POLITICAL MARKETS* 91 (1981); Ludwig von Mises, *The Clash of Group Interests*, in *APPROACHES TO NATIONAL UNITY: FIFTH SYMPOSIUM OF THE CONFERENCE ON SCIENCE, PHILOSOPHY, AND RELIGION* 148 (Lyman Bryson et al. eds., 1945), *reprinted in* *MONEY, METHOD, AND THE MARKET PROCESS: ESSAYS BY LUDWIG VON MISES* 202 (Richard M. Ebeling ed., 1990).

197. As a result of the limited influence of each individual on the contents of the legislation that is passed in a democratic regime, the "rational ignorance" phenomenon arises. *See* Ilya Somin, *Essay, Voter Ignorance and the Democratic Ideal*, 12 CRITICAL REV. 413, 435-38 (1998).

198. Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1645-46 (1996).

199. BRUNO LEONI, *FREEDOM AND THE LAW* 22 (3d ed. 1991).

rule.²⁰⁰ The detachment from the market forces in the state model and the accompanying lack of information lead to incompatibility between market needs and the legislation that is formulated. They result in the adoption of inefficient laws.

Moreover, the described inefficiency relates not only to the substance or quality of the laws that are enacted under the state model, but also to their quantity. Due to the fact that changes to legislation are not a direct function of consumer pressure and to the fact that lawmakers can externalize some of the enforcement costs associated with legislation, we are witness to the phenomenon of over-legislation. The corpus of state law has grown to enormous proportions, in excess of market needs, and is subject to excessively frequent changes.²⁰¹ Modern society is collapsing under the weight of hyperlexis,²⁰² which is reflected in the prevalence of weighty and complex laws, overflowing with minute details, as well as in the many and frequent permutations of those laws. As a result of this inflation in laws and regulations, the ordinary citizen lacks the tools and ability to function effectively in the legal space.²⁰³ The vast dimensions of the body of state law, as well as the inability to sort through the mountains of information it encompasses, rule out, to a large extent, any ability to regard it as “*a known body of law.*” In this sense, the claim can be made that it is in fact the state legislative systems that suffer from the legislative failure Locke ascribed to the state of nature.²⁰⁴

The problems inherent to the public legislation system are not unique to statutory legislation. Scholars such as Rubin, Priest, Posner, and Goodman maintain that the relative decentralization of judge-made law will lead to the formulation of legal rules of basically efficient content. And yet we find in judicial legislation the very same underlying problems of lack of information and faulty incentive system that characterize all public bodies. Similar to

200. This contradicts, of course, the “constructive rationalism” fiction at the base of the positivist approach, which is grounded on the conceptual ability of centralist bodies, such as the legislature, to store and process the information relevant for constituting an efficient and proper legal regime.

201. For further discussion of the “inflation” in state legislation, see LEONI, *supra* note 199, at 17.

202. AUERBACH, *supra* note 10, at 9.

203. As a result of this, in many fields people do not even bother to familiarize themselves with the letter of the law or to learn the “applicable law,” which is instead replaced by social norms and accepted customary rules. See ELLICKSON, *supra* note 15; see also Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123, 1126 (1997).

204. Roderick T. Long, *The Nature of Law Part I: Law and Order Without Government*, 1 FORMULATIONS (1994) (on file with the University of Michigan Journal of Law Reform), available at <http://libertariannation.org/a/fl312.html>.

statutory legislation, the state judiciary system also enjoys monopoly power. The public is forced to accept the binding force of the legal precedent.

Moreover, it may be claimed that the very pursuit of *the* efficient legal rule, under the “efficiency of the common law paradigm,” is a futile attempt. The search for *the* efficient legal rule rests on the latent premise that there is one uniform efficient legal rule for the entirety of the public.²⁰⁵ However, the very assumption of a monolithic and uniform legal rule can impede efficiency. A public system that supplies, by definition, monolithic and uniform law may be inefficient for this very reason alone.

In general, the public supply of law is grounded on a faulty incentive and informational foundation for achieving efficiency. The state legislation and adjudication mechanisms are weighed down by bureaucracy, produce “too much law,” and impede the ability to monitor and control the quality and quantity of the legal product. Since government intervention leads to an oversupply of law, even the concern of under-supply of laws and legal rules in the framework of the private market (due to their nature as public goods) does not *a priori* tip the balance in favor of government intervention. A comparison must be made between the costs embodied in legislative under-innovation and those entailed in over-innovation.²⁰⁶ The same holds in the context of attaining the optimal extent of standardization in the law. Whereas a private market is likely to reach a state of legal under-standardization, a public market is likely to be over-standardized. The broader picture reveals that, in fact, every market failure in the private model of law has a counterpart in the political market, which adheres to the state law model. The claim being made, therefore, is that the inherent drawbacks of a private legal system must be assessed in light of the shortcomings typifying public legal systems. We must not focus exclusively on the failures of the private model, led by the assumption that the government can fix them at zero cost. Proponents of the state solution must show, additionally, that this systemic structure for supplying the law produces more efficient outcomes than those that emerge under a private structure.

Most importantly, even if at the end of the day it emerges that its market failures turn the private model into the less attractive option of the two, this does not end the discussion. The two alternatives—full privatization of the legislation and adjudication markets versus the complete state law model—do not exhaust the

205. Further on I address the economic utility embodied in the existence of uniformity.

206. BENSON, *supra* note 4, at 286.

entire spectrum of possibilities for the relationship between the state and the law. Between these two extremes of absolutely no state intervention in the law (full privatization of the legislative and judicial functions) and full intervention (monocentric state law), there is a long row of intermediate formats of limited state intervention. These moderate configurations rest on the abandonment of the dichotomy that arises from the Hobbesian and Lockean doctrines, between a monocentric public legal order and sweeping non-intervention on the part of the state. These middle-ground solutions can take many different forms, such as dividing the state law into a number of possible legal protocols²⁰⁷ or establishing a federal legal system in which the majority of the legislation and adjudication activity occurs at the local level.

The rest of the discussion will be devoted to outlining the contours of one such intermediate point along the privatization spectrum. In this framework, I will seek to illustrate how it is possible to correct the market failures of the legislative and judicial markets with state intervention that is more limited than that characterizing the monocentric state law model. I will show that despite the fact that state intervention is imperative for ensuring the funding and supply of public goods in these markets, overcoming these market failures does not mandate, and does not justify, the monopolistic production of legislative and judicial services by the state.²⁰⁸ The same is true with regard to the cartelization tendency: I will show that thin state intervention, aimed at antitrust arrangements in the legislation and adjudication markets, will successfully neutralize this market failure.²⁰⁹ In other words, I will demonstrate by means of the intermediate model that the mere identification of market failures in the markets for legislation and adjudication does not serve to justify the monopolistic model of state law. This has implications also for the Hobbesian and Lockean justifications discussed above: if it is possible to correct the failures in the administration of justice in the state of nature by way of state intervention that is more restricted than the monocentric state law model, then the teleological component of their doctrines loses its justificatory force.

207. For an interesting analogy in the context of international law, see Mark J. Sundahl, *The "Cape Town Approach": A New Method of Making International Law*, 44 COLUM. J. TRANS-NAT'L L. 339 (2006).

208. See GARETH D. MYLES, *PUBLIC ECONOMICS* 236 (4th ed. 2002).

209. For an analogous claim made in the context of the protection market, see John Hasnas, *Reflections on the Minimal State*, 2 POL., PHIL. & ECON. 115, 123–24 (2003) (discussing the remedial state, which is more limited than the minimal state, in that it is restricted to correcting failures in the market for protection, as opposed to supplying protection services by itself).

PART C: A PROPOSAL OF PARTIAL STATE INTERVENTION IN THE
SUPPLY OF LEGISLATION AND ADJUDICATION

The intermediate model that I will discuss here rests on reciprocity between the public legal system and the private systems and on using each system to improve the functioning of the other. The proposition conceives of the existing state law model and the fully privatized model as complementary solutions, as opposed to mutually exclusive alternatives, for the supply of legislative and judicial services. Although not completely eliminating the institution of state law, it turns the majority of the system into default rules, while simultaneously granting sweeping rights to opt out in favor of private legal regimes and adjudicative bodies.²¹⁰ Coercive state law is reduced to a small kernel, limited to correcting the failures of the legislative and judicial markets. The enforcement function will remain in the state's hands, which, in addition to public judicial verdicts, will enforce also the decisions made in the framework of the state-licensed private adjudicatory systems. The "players" in the legal arena alongside the state will be the private legislative and judicial entities that are granted official recognition. These law agencies will be able to set choice of law rules for ordering the network of relations amongst themselves. It will be possible for them to apply one set of legal rules for intra-agency interactions amongst members of the same agency or legal community and another set of rules for "boundary-crossing" interactions between one agency's members and the members of other agencies. Each of these points will be expounded on below.

Under the proposed model, there will be a general right to opt out of the state law for private legal agencies. This right will grant an exemption from the component of the general tax that relates to legal services (payment for the funding of the public law system will be made by means of the legal agencies to which the exiting individuals belong). In addition, an individual who chooses to opt out of the public legal system will not be subject to the default state legislation. However, at the same time, he will be precluded from making use of the state law: he will not be able to file a suit based on the state law, nor will he be able to resort to the services of the state judicial system in the event of a dispute. Rather, he will be

210. Exit rights have been defined by Dagan and Heller as "voluntarily leaving the effective jurisdiction of the group." Hanoch Dagan & Michael A. Heller, *The Liberal Commons*, 110 YALE L.J. 549, 568 (2001) (quoting Leslie Green, *infra* this footnote). For an extensive discussion of the issue of exit, see also ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970); Leslie Green, *Rights of Exit*, 4 LEGAL THEORY 165, 171 (1998).

subject to the legislative and judicial orders of the law agency he chose upon exiting. (One possible exception, which will be clarified further on, would be in the context of the arbitration of disputes between an individual who chose to exercise his right to exit the public system and the private law agency to which he belongs. In such cases, it will be possible to appeal to the public system to adjudicate the dispute.²¹¹) At the same time, the option of partial exit will also be available, incidental to a specific dispute or particular legal context. Partial exit will not accord a general exemption from paying tax for the public system; moreover, the partially exiting individual will remain subject to the state legal order except in the framework of the specific area in which he chose to exercise his exit right. *Ex-ante* exercise of the exit right will also be possible, that is, in pre-dispute situations, and in such cases, unilateral exit will be sufficient. Alternatively, it will also be possible to realize the exit right *ex-post*, particularly in post-dispute contexts, but this will be contingent on the consent of all involved parties (similar to the current practice of signing an arbitration note).

The state legal system will remain for the purpose of the following four central goals:

1. The public system will serve individuals or bodies that have refrained from *ex-ante* realization of their right to opt out of the public system and have chosen to continue to belong to this system. These individuals will be required to pay the tax component related to supply of legal services and release from this payment will be subject to the current criteria for a general income tax exemption. Anyone who does not exercise their right to exit the public legal system will automatically continue to make use of the system, as is currently the case.
2. The state system will constitute the default system for determining disputes between different law agencies, whenever these agencies do not succeed in settling the disputes between them (or between their customers) by peaceful means. In determining these disputes, the public judges will be authorized to rule based on the state law but also to deviate

211. An additional exception relates to those situations in which the parties to a dispute choose jointly to turn to the state system, after having exited at an earlier stage. In such cases, the appeal to the public system will entail a one-time-only fee, which will be significantly higher than the symbolic fee paid by someone who did not make a-priori use of his right to exit the public system.

from that law when justice considerations so mandate. They will also be permitted to refer the dispute between agency *A* and agency *B* to private agency *C* for determination.

3. A third purpose of the public system will be the arbitration of cases between individuals who opted out of the state system and the law agencies to which they chose to belong.
4. The state law system will also order the private law market. It will set the licensing mechanisms for private law agencies and will order the prevention of antitrust arrangements in the markets for legislation and adjudication.

Each private law agency that applies for a license will be required to make an ongoing tax payment to the public system. In addition, when appealing to the public judicial system (due to the emergence of a dispute between two legal agencies), private agencies will be required to pay a fine to the public system that is higher than the regular tax payment. This fine will serve a dual purpose: it will be used both to fund the public system and for the purpose of creating a positive incentive for the law agencies to resolve their disputes peacefully. Alongside the *ex-ante* right to exit the public system, an *ex-post* exit right will also be granted, subject to the consent of the two sides to the dispute. There will also be a symmetrical *ex-post* ability to exit the private systems and to return to the state judicial system.

The public enforcement system will enforce only decisions handed down by authorized law agencies. The cumulative criteria that must be met for private law agencies to receive a license and accreditation will be as follows:

- 1) a minimal amount of members who voluntarily choose to belong to the private agency;²¹²
- 2) regular payment of a tax to the state treasury (for the purpose of maintaining the public system) and payment of fines for turning to the public system in the event of a dispute with a competing agency; and
- 3) meeting the legal standards set by the state legal system for private law agencies in general as well as

212. The intention here is to a minimal number that is set in advance and not to a numerical standard that will be susceptible to government manipulation and tinkering, for giving the government such latitude would open the door to political impact on the market for private ordering.

with regard to the specific law agency (this refers to the state system's decisions in the context of anti-trust in the private law industry, as well as judicial decisions rendered by the state system against the particular agency in suits brought by one of its customers).

Under the proposed model, the "exit right" is defined as referring only to exit in favor of a recognized private system; that is, only transfer to a private legal system that has met the stated requirements and criteria will release the exiting individual from the binding authority of the state law (and entitle him to an exemption from paying the tax for the public system). Resort to a non-accredited and unauthorized legal system will be devoid of any meaning: it will not constitute opting out from the state legal system, and the person who appeals to that system will be seen as continuing to belong to the public system (or to the private legal system to which he belonged at the time of the appeal to the unrecognized agency).

When a dispute arises, each side will appeal to his or her legal agency. In disputes between parties that belong to the same private legal body, judges from the shared agency will make their rulings based on the normative system that is applied in its framework, and the decision will be enforced by the public enforcement system. In instances in which the parties to the dispute belong to different law agencies, however, the arrangement will be decided by the choice of law rules that will form between these law agencies (similarly to the rules existing today in the private international law sphere). Thus, as repeat-players in the system, it will in many instances be of advantage to the agencies to set *ex-ante* choice of law rules or at least to do so in an ad-hoc fashion retroactively. The private law agencies will operate similarly to today's insurance and credit companies: the agency will store information regarding its clients and will act as guarantor in those instances in which clients have acted in accordance with its legal criteria but have nonetheless become embroiled in a legal dispute. The state system will serve as the default forum for determining disputes between different law agencies, whenever they fail to settle between them, and the law agencies will be required to pay a considerable fee for such resort to the public system.

The right to opt out of state law will be limited also insofar as anti-trust regulations regarding the law industry are concerned. State law will regulate the private law market and will make illegal any activity that in any way creates a trade restraint in the private law

industry. A law agency will be permitted to appeal to the state legal system if it encounters barriers to entering the law market placed by other law agencies (for example, the latter enter into an agreement to prevent their clients from entering into contracts with the members of the new agency). In addition, standing will be granted also to the consumer public: every individual will be entitled to appeal to the state courts for the purpose of deliberating the matter of antitrust in the markets for legislation and adjudication.

This is only a preliminary sketch of a possible alternative to the state law model in its present format. Any number of more complicated permutations are possible, such as allowing concurrent membership in more than one accredited legal agency—in different areas of social ordering or with regard to legal interactions with different entities. It is also possible to think of scenarios in which individuals will be able to purchase legislative and judicial services not only from private systems within the state's borders but also from competing legal systems in other states. Another of the many possibilities relates to the institution of mechanisms such as class actions brought by individuals or agencies.²¹³

The purpose of outlining this alternative polycentric legal regime has been twofold. The first goal was to point to the existence of weak links in the connection drawn in the teleological element of the Hobbes and Locke doctrines. A second goal was to propose and initiate discussion of an alternative legal regime, with the ability to replace both the state law model and the fully private model, discussed at the outset of this Article.²¹⁴ In the discussion below, I will turn to consider some of the advantages and disadvantages inherent to this intermediate model relative to each of the two extreme alternatives: full privatization or monopolistic state law.

213. In the present reality, we are also witnessing the opening up of the legal market to a certain degree of competition, especially with regard to the judicial function; for example, there has been the emergence of a range of alternative procedures for determining and settling disputes, most prominently, the arbitration procedure. But this notwithstanding, the privatization of legislation and adjudication and the right to exit the state legal system are currently immeasurably limited relative to the intermediate model outlined here. Thus, for example, under the proposed model, the comprehensive right to exit the state judicial and legislative systems will not be limited to the civil sphere or to specific legal fields; moreover, this model exempts, even if partially, those exiting the public system from the burden of its funding. An additional important divergence relates to the focus on the legislative function: the majority of the initiatives for privatizing the law thus far have been directed at the judicial function, whereas the proposed model places emphasis also on privatizing the legislative function and the setting of social policy. Finally, under the proposed model, a change can be expected in the extent of the public system's monitoring of the private alternatives. State intervention, for example, in the context of licensing, should be based on essentially formal demands and not on substantive normative contents.

214. See *supra* Part A ("A Private Market for Law").

THE ADVANTAGES OF THE PROPOSED MODEL RELATIVE TO THE
FULLY PUBLIC MODEL OF MONOPOLISTIC STATE LAW

In the framework of the model proposed here, the state legal system will be propelled towards greater efficiency,²¹⁵ since it will be exposed, even if only partially, to the forces of competition. The shift of consumers to the private systems will alleviate the overloading that currently exists in the public system. Similarly, the private consumption will provide clearer and more precise indications of the real value of the judicial and legislative services offered to the consuming public. It will be possible to make use of the information that will materialize to limit government subsidization of law services to the public utility component alone, thus preventing over-subsidization of the public judicial system.

The dispersal of the power to legislate amongst competing bodies that check and balance one another will serve as a defense mechanism against dangerous social experiments. Under a centralized legislative regime, the social cost of errors in legislation is high, due to their broad potential applicability. Under a polycentric model of law, in contrast, each individual legal agency has a lesser impact on society as a whole.

Decentralizing the power to legislate can also be expected to bolster the weaker sectors of the state collective. Populations that are not represented effectively in the state framework will be able to exercise their exit right collectively and institute legal orders that reflect their normative worlds, particularly in internal community contexts, assisted by the state enforcement mechanisms for executing private judicial decisions. Not only will this improve the situation of social minority groups, but it will also improve the extent of the state law's compatibility with general social interests. This will be achieved by means of instituting legal standards by which the state law rules can be measured and evaluated; indeed, the state legal rules will be sifted through the filter of the private norms to examine the extent of the state law's bias in favor of its stakeholders' interests. Moreover, in situations in which the state law serves merely as a mouthpiece for dominant sectors of the state communality and reflects solely the normative alignment of the social elites, other social groups will choose to move to private systems that better reflect their own normative world. The more the public system shrinks in size, the more expensive the transaction costs will become for its remaining members in their interactions

215. See Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23, 34 (1983).

with the other parts of the population. This will lead to a situation in which those with a vested interest in the public system will have an incentive to pass legislation that is more appealing to the general public, that is to say, legislation that reflects more precisely the “general social interest” and responds to the needs of broader sectors of society.²¹⁶ The decline of the status of the state law under the proposed model will likely generate a parallel decline in its role as the wager of social struggles and the source of political conflict. The state law will continue to enjoy a certain preferential status and thus will continue to be the focus of the activity of special interest groups; however, it can be assumed that this phenomenon will wane, particularly due to the ability of entire social groups to opt out of the state system and arrange their intra-community legal matters as they see fit. In addition, the right to exit the public system can be expected to reduce also the problems of the collective decision making mechanisms. This will result from, amongst other things, the minimization of the incentive for rational ignorance: under the democratic model, a negative incentive exists for the individual voter to invest the costs and resources entailed in gathering the information necessary for making an educated choice in the general elections. Part of the difficulty stems from the public good characteristics of participation in the democratic process. The negative incentive to invest in amassing information and participating in the election procedure intensifies on the background of the fact that, in the framework of large groups, the lone voice is unlikely to tip the balance either way or to have a determinative impact on the legal policy that is eventually adopted and implemented. Under the state model, the question of whether the implemented legal policy reflects the will of the individual is not connected to the way in which that individual votes in the elections. In this way, the public dimension of voting is further reinforced, as is the phenomenon of rational ignorance on the part of the voting public. However, the very existence of sweeping exit rights will turn the participation in the legal functions into an individual activity and will minimize their basic collective dimension. Since under the proposed model, each individual will have the ability in principle to decide according to which legal policy he acts and in which legal system he participates, the incentive for him to amass and process the information necessary to making a successful choice will increase.

216. Erin A. O’Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, 1161 (2000).

THE ADVANTAGES OF THE PROPOSED MODEL RELATIVE TO THE
FULLY PRIVATE MODEL

The proposed model provides mechanisms for contending with the market failures that arise in private markets for legislation and adjudication discussed above. First and foremost, with regard to the supply of public goods entailed in the judicial function, the intermediate model corrects the flaw in the fully private model, which originates in the exclusive reliance on self-interest for peaceful resolution of disputes (whether between individuals, entities, or groups). Due to the possibility of residual coercive resort to the state judicial system, the model responds to and ensures a final determination of disputes in society. The model's inherent mechanisms for funding the public judicial system diminish the ability of those exiting in favor of private judicial systems to free-ride on the back of the public judicial system.

The same is true with regard to the market for legislation. The state system will preserve its strength in creating legal rules, and due to the fact that private systems must compete effectively with the public system in order to survive from a business perspective, they will be incentivized to initiate legislation themselves. The state law will continue to enjoy a certain extent of preferential status (as the legal corpus by which disputes are likely to be residually determined); this will assist in the attempt to contend with the free-riding phenomenon in the supply of public goods that are extraneous to the law, such as foreign defense. The feedback from the state system will ensure an opening for escaping the problem of over-standardization and legal lock-in. Due to the state's ability to ensure a concentrated shift to preferable legal rules and due to the private law agencies' need to compete with the state system, there will be less incentive for the private systems to lock-in on an inferior legal standard. Finally, the regulatory supervision of the private law agencies for the purpose of preventing antitrust arrangements will assist in decreasing the probability of cartelization in the market for law. Moreover, the very existence of a competing public legal authority will, in itself, diminish the damage potential of such a private legal cartel.

POSSIBLE CRITICISM OF THE INTERMEDIATE MODEL PROPOSED

The proposed model is, of course, not devoid of flaws, in comparison to both the public model and the fully private model. I will begin from the first perspective. Under the intermediate model,

the state will supply enforcement services also for decisions that are rendered by the (authorized) private tribunals. This is despite the fact that the state's representatives will have no foothold in the judicial or legislative procedures on which the private judicial verdict is based. The externalization of the enforcement costs by the private law agencies could lead to an over-exploitation of the public enforcement services and to the enlistment of enforcement mechanisms for very controversial goals that are not acceptable to the majority of the public (especially in contexts of inter-community disputes).

This criticism can, however, be qualified, for under the current public model, similar questions arise of over- and under-enforcement, but not between law agencies, but between individuals. There are those who overuse the public judicial and enforcement apparatuses, due to their failure to take into consideration the social cost of enforcement. Others fail to make adequate use of these systems due to a failure to internalize the social utility of enforcement. Moreover, the problem of externalization in enforcement emerges under the public model also in systemic contexts and political frameworks: due to the representative problems that arise in the entire legislation procedure and the ability of elected officials to externalize the costs of enforcement to taxpayers, the problems of "over-legislation" and "over-enforcement" arise systemically also in the framework of the public model.

The enforcement question has been generally excluded from the framework of the discussion. But we can certainly enhance the proposed model by thinking of mechanisms that will enable private law agencies to participate in funding the costs of enforcement, in a way that contends with the problematic incentives for non-optimal enforcement.

Another possible line of attack on the intermediate model could be from the distributional perspective. One of the difficulties entailed in granting a possibility of opting out from public services relates to the negative effect that the exit of the strong sectors could potentially have on the functioning of the public systems.²¹⁷ The concern is that rich consumers' ability to free themselves to a considerable extent of the state legal systems will leave the weaker sectors to be the sole consumers of those systems and will eventually impair the legal services the latter receive. The weak sectors will be forced to contend with the harsh reality of a (likely dra-

217. Somin, *supra* note 3, at 803.

matic) deterioration in the quality of the law services supplied to them by the public system.

There is room, however, to challenge the premise underlying this criticism that the underprivileged are destined to be injured by the exit of the rich from the public law system. Serious doubt can be raised with regard to this assumption, which, in turn, is grounded on the latent premise that current public state law systems fundamentally operate to the advantage of the weak sectors. In many cases, government services, in general, and legislative and judicial services, specifically, in fact reinforce regressive trends.²¹⁸ In the legal context, this is reflected in the economic barriers erected on the way to court, which deprive the underprivileged of effective access to the state courts, in contrast to the stronger sectors of the population who overuse the system. The law's bias in favor of the society's strong sectors is also evident in how the state law functions in shaping social behavior, given the political inferiority of the weaker populations and their inability to organize politically to promote their interests, as compared to stronger sectors and interest groups. The outcome is, amongst other things, use of the criminal apparatus as a tool for repressing weak populations and over-representation of these sectors in the ranks of the accused. This joins the fact that low income earners also tend to be the victims of criminal activity to an extremely disproportionate extent relative to their overall representation in society. In fact, diminishing strong groups' consumption of the public systems, while at the same time ensuring their participation in their ongoing funding, might actually improve the law services enjoyed by low income earners relative to their current options.

Moreover, the right to exit the state law under the intermediate model, its broad scope and significance notwithstanding, will not be a full exit right. The state will retain residual authority in dispute determination, and thus even those who choose to consume private legislation and judicial services will remain with a certain tie to the public system.

It is also possible to criticize the proposed intermediate model from the perspective of the fully privatized model. There are drawbacks even to limited state intervention in the market for law. Thus, under the proposed model, although the core of state intervention will occur on the enforcement front, a not negligible extent of intervention can be expected also in the context of the legislative and adjudication functions. This will be executed by way of restrictions placed on the right to exit the public system, as well

218. *Id.* at 804.

as through government intervention in the licensing procedure for private law agencies. The public supervision over entry into the market for law and monitoring of the law agencies' functioning from the moment of their entry, while binding them to uniform standards in certain fields, open up the possibility of state impact on the substantive contents of the private law systems.

An additional difficulty inherent to the proposed model relates to the natural bias that will emerge in its framework in favor of the state law and the likely consequent harm to the ability of private legal bodies to function as an attractive alternative to the state system. As described, the public legal system will continue to enjoy a certain preferential status. To begin with, only the state system will enjoy government subsidization. Moreover, the public system will retain residual authority in determining disputes, and this preferential status will have implications also for the normative contents of the private systems (particularly in inter-agency interactions). In this respect, while the proposed model can be expected to mitigate the preferential status of the state model, it will not completely eliminate the latter's advantageous position.

This leads to an additional shortcoming, which touches on the legal standardization phenomenon and the tendency towards over-conformity with the state law. Due to the state legal system's relatively preferential status as well as the network structure of the law industry, private law systems will have a diminished effective inclination to deviate from the normative order prescribed by the state law in extra-agency contexts. On the one hand, this will act as a sort of "safety net" under the proposed model, both against excessive legal divergence and against the infiltration of problematic legal contents into the private sector (at least with regard to the ordering of behavior between agencies or between communities). Yet on the other hand, it will also likely significantly reduce the advantages of privatizing the market for law and the positive consequences of making the legislative and judicial functions susceptible to the market forces. This phenomenon is likely to place a practical limitation on the innovativeness of the legal arrangements that emerge in the market for law.

However, there is a most simple response to this final line of criticism: even if these pessimistic predictions do materialize, at the very worst, we return to our current point of departure—a monocentric model of state law.

In sum, setting a thin public system alongside the private systems will produce some of the fruits of privatization, while limiting the accompanying exposure to the market failures likely to arise in a

completely private market for law. At the same time, it will be possible to reap some of the benefits of public supply of the law, without having to suffer (to any significant extent) the disadvantages of monopolistic public systems.

CONCLUSION

The Hobbesian and Lockean social contract theories promote a monolithic public legal order. From the ills of the social ordering in the state of nature, the two thinkers drew their justification for concentrating the legislative and judicial functions in the hands of the state sovereign. Hobbes spoke of the sovereign in terms of “sole legislator,” while Locke viewed as the solution the creation of a constitutional government—a regime in which the state monopolizes the legislative, judicial, and enforcement functions (with the state agent divided into three branches in this context).²¹⁹ The legal model that I have roughly outlined was intended to illustrate the ability to correct the failures in the market for law also in the framework of a polycentric legal regime, based on more limited state intervention in the law. The conclusion that emerges is that Hobbes’s and Locke’s claims are valid and compelling arguments with regard to the justification for state intervention *per se* in the markets for legislation and adjudication, but are not a sufficient basis for justifying the state law model and the intervention in the form of a state monopoly over the law. Indeed, state intervention is vital for creating the space in which legal regimes and systems for dispute determination can grow and set rights. It is not necessary, however, that the state set these rights itself.

The model that was reviewed here as a preliminary point of reference represents one possible—but not mandatory—intermediate solution along the spectrum of privatization. It is possible to conceive of a whole variety of additional configurations of the privatization of the legislative and judicial functions, also supported by the theoretical foundation laid in the framework of this Article—from “lighter” alternatives such as granting broader recognition to customary law in the framework of formal law, to instituting mediation proceedings in criminal disputes or forming legal federations,²²⁰ to more radical models of privatization, such as

219. See Long, *supra* note 204.

220. Such a model is likely to be based on broader legislative decentralization and on the shifting of the hub of legislation and adjudication to the local municipal sphere. While the model does preserve the link between law and territory, it also expands individuals’ choice options with regard to the legal system to which they will be subject. For, indeed, the

instituting a voucher system for the consumption of legislative and judicial services.²²¹ Anchored in the theoretical discussion that unfolded here, it is possible to call for a gradual progression of the legal system towards the private end of the spectrum and for the removal of the artificial impediments currently blocking the way to private supply of legislative and judicial services.

local systems will be able to offer legal baskets that are distinct from those offered by neighboring local authorities. As a rule, the greater the extent of social behavior ordering executed on the local plane, rather than in the state sphere, the lower the costs of moving between legal authorities, and the greater the individual's ability to influence (by way of exit) the legal world under which he operates. This model represents the application to the legal sphere of Tiebout's model for supplying public goods. See Tiebout, *supra* note 17.

221. In this context, consider the school vouchers suggested by Milton Friedman, MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 85-107 (1962), and the protection vouchers proposed by Nozick, NOZICK, *supra* note 166, at 26-27.