THE FORMATION OF CUSTOMARY LAW

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A fundamental insight of the economic analysis of law is the notion that legal sanctions are "prices" set for given categories of legally relevant behaviour. This idea develops around the positive conception of law as a command backed by an enforceable sanction. Law and economics uses the well-developed tools of price theory to predict the effect of changes in sanctions on individual behaviour. One essential question, however, remains unanswered: How can the legal system set efficient prices if there is no market process that generates them? In other words, how can legal rules reflect the level of social undesirability of the conduct being sanctioned?

Although the legal system sometimes borrows a price from the actual market (e.g., when the sanction is linked to the compensatory function of the rule of law), there is a wide range of situations in which legislative and judicial bodies set prices in the absence of a proper market mechanism. In a law and economics perspective, customary law can be viewed as a process for generating legal rules that is analogous to a price mechanism in a partial equilibrium framework.

Both the emergence of custom from repeated contractual practice and the role of custom as a non-contractual solution to game inefficiencies have been the object of study in both the economic and philosophical literature. Law and economics has revisited this familiar theme, considering the spontaneous emergence of customary law, and, more recently, emphasizing the issue of legal and institutional change in an evolutionary setting (See, e.g., Cooter, 1994; Parisi, 1995; E. Posner, 1996; Bernstein, 1996).

Here, I present the standard theory of customary law, discussing the domain of custom among the spontaneous sources of legal order.

This study explores the formative elements of customary rules and their legal effects. Game-theoretic models become useful tools to evaluate the sufficiency of customary law as an exclusive source of social order. In addition to considering the commonly criticized problems of inaccessibility and inelegant fragmentation, this study attempts to characterize the institutional settings that remain outside the reach of spontaneous cooperation, and the situations under which inefficient customary rules may develop and persist. Further, this study will consider the public choice dimension of the process of customary law formation, considering the potential for norm manipulation. The conclusion will addresswhether of an increased recognition and incorporation of customary norms by the legal system is desirable.

I. The Theory of Customary Law

In the "social contract" framework, customary rules can be regarded as an implied and often non-verbalized exercise of direct legislation by the members of society. Those legal systems that grant direct legal force to customary rules regard custom as a primary, although not exclusive, source of law. In such legal traditions, courts enforce customary rules as if they had been enacted by the proper legislative authority. Custom thus amounts to a spontaneous norm which is recognized by the legal system and granted enforcement as a proper legal rule.

Judicial recognition of spontaneous norms amounts to a declaratory (rather than constitutive) function that treats custom as a legal fact. The legal system “finds” the law by recognizing social norms, but does not “create” the law. The most notable illustration is the system of international law, where, absent a central legislative authority, custom stands next to treaties as a primary source of law. (See, e.g. Article 38 (1) of the *Statute of the International Court of Justice*; and Restatement 102 of the *Foreign Relations Law of the*

United States).

Whenever they are granted legitimate status in a legal system, customary rules are usually given the same effect as other primary sources of law. Although often subordinated to formal legislation, customary rules derive their force from the concurrence of a uniform practice and a subjective belief that adherence to them is obligatory (*opinio iuris*), without necessarily being formally incorporated into any written body of law. For this reason, they are usually classified as "immaterial" sources of law (Brownlie, 1990). This notion implies that the custom remains the actual source of law even after its judicial recognition. In this setting, the judicial decisions that recognize a custom offer only persuasive evidence of its existence and do not themselves become sources of law. In turn, this prevents the principle of *stare decisis* from crystallizing customary law.

Modern legal systems generally recognize customary rules that have emerged either within the confines of positive legislation (*consuetudo secundum legem*) or in areas that are not disciplined by positive law (*consuetudo praeter legem*). Where custom is in direct conflict with legislation (i.e., *custom contra legem*) the latter normally prevails. In some instances, however, a custom supersedes prior legislation (i.e., *abrogative custom*), and some arguments have been made in support of emerging practices that conflict with obsolete provisions of public international law (*desuetudo*, or abrogative practice) (Kontou, 1994). The theoretical and practical significance of these forms of spontaneous social order, which compete with enacted law in influencing human choice, are discussed below.

The Anatomy of Customary Law

The theory of customary law defines custom as a practice that emerges outside of legal constraints, and which individuals and organizations spontaneously follow in the course of their interactions out of a sense of legal obligation. Gradually, individual actors

embrace norms that they view as requisite to their collective well-being. An enforceable custom emerges from two formative elements: (a) a quantitative element consisting of a general or emerging practice; and (b) a qualitative element reflected in the belief that the norm generates a desired social outcome.

(A). *The Quantitative Element*. The quantitative requirements for the formation of customary law concern both the length of time and the universality of the emerging practice. Regarding the time element, there is generally no universally established minimum duration for the emergence of customary rules. Customary rules have evolved from both immemorial practice and a single act. Still, French jurisprudence has traditionally required the passage of forty years for the emergence of an international custom, while German doctrine generally requires thirty years. (See Tunkin (1961); and Mateesco (1947)). Naturally, the longer the time required to form a valid practice, the less likely it is for custom to effectively anticipate the intervention of formal legislation, and to adapt to changing circumstances overtime.

Regarding the condition of universality, international legal theory is ambivalent. Charney (1986) suggests that the system of international relations is analogous to a world of individuals in the state of nature, dismissing the idea that unanimous consent by all participants is required before binding customary law is formed. Rather than universality, recent restatements of international law refer to "consistency" and "generality." (See D'Amato, 1971). Where it is impossible to identify a general practice because of fluctuations in behavior, the consistency requirement is not met. (See *Asylum case* (1950), at 276-7; and *Wimbledon case* (1923), Ser. A, no. 1.). Similarly, more recent cases in international law restate the universality requirement in terms of "increasing and widespread acceptance." (See, e.g., *Fisheries Jurisdiction case* (1974), at 23-6; *North Sea Continental Shelf cases* (1969), at 42), allowing special consideration for emerging general norms (or local clusters of

spontaneous default rules) that are expected to become evolutionarily stable over time.

With regard to rules at the national or local level, the varying pace with which social norms are transformed suggests that no general time or consistency requirement can be established as an across-the-board condition for the validity of a custom. Some variance in individual observation of the practice should be expected because of the stochastic origin of social norms. A flexible time requirement is particularly necessary in situations of rapid flux, where exogenous changes are likely to affect the incentive structure of the underlying relationship.

(B). *The Qualitative Element*. The second formative element of a customary rule is generally identified by the phrase *opinio iuris ac necessitatis*, which describes a widespread belief in the desirability of the norm and the general conviction that the practice represents an essential norm of social conduct. This element is often defined in terms of necessary and obligatory convention. (Kelsen, 1939 and 1945; D'Amato, 1971; and Walden, 1977). The traditional formulation of *opinio iuris* is problematic because of its circularity. It is quite difficult to conceptualize that law can be born from a practice which is already believed to be required by law.

The practical significance of this requirement is that it narrows the range of enforceable customs: only those practices recognized as socially desirable or necessary will eventually ripen into enforceable customary law. Once there is a general consensus that members of a group ought to conform to a given rule of conduct, a legal custom can be said to have emerged when some level of spontaneous compliance with the rule is obtained. As a result, observable equilibria that are regarded by society as either undesirable (e.g., a prisoner's dilemma uncooperative outcome) or unnecessary (e.g., a common practice of greeting neighbours cordially) will lack the subjective and qualitative element of legal obligation and, therefore, will not generate enforceable legal rules.

Terminology Compared

The concept of *opinio iuris* introduces a distinction between mere behavioural regularities and internalized obligations. This distinction may be related to the parties' awareness of the expected aggregate payoffs from the game, a distinction that is crucially important in the normative setting. Two categories of social rules are generally distinguished: (a) those that reflect mere behavioural patterns that are not essential to the legal order; and (b) those that reflect an internalized belief that the practice is necessary or socially desirable. A mere behavioural regularity, lacking the qualitative element of *opinio iuris*, does not generate a customary rule. In legal jargon, such behaviour is a mere usage; in economic terms it simply represents an equilibrium convention. On the other hand, norms considered necessary for social well-being are treated as proper legal customs and can enter the legal system as primary sources of law.

Finally, the terminology used in the legal and economic literature should be contrasted with the terminology employed in sociological literature. (See, e.g., Weber, 1978 at 319-20). What is legally termed a mere usage is defined in sociological literature as a custom (*Sitte*), in the sense of a typically uniform activity that is not considered to be socially necessary. Convention–the sociological notion closest to the legal concept of custom–amounts to conduct manipulated by express approval or disapproval by other members of the group, but lacking the enforceability that characterizes a legal custom.

II. The Emergence of Customary Law

As discussed above, two elements are generally required for the finding of customary law: (1) the practice should emerge out of the spontaneous and uncoerced behaviour of various members of a group,

and (2) the parties involved must subjectively believe in the obligatory or necessary nature of the emerging practice (*opinio iuris*). To an economist, the first element corresponds to the rather standard assumption of rational choice. The second element may be appraised as a belief of social obligation, emerging in response to game inefficiencies, to support behavioural rules that avoid aggregate losses from strategic behaviour.

This part examines some additional structural conditions for the emergence of customary law. The stylized settings considered shed light on the more problematic cases where conflicting incentives are inconsistent with individual preferences over alternative outcomes. In stochastic or induced symmetry, the spontaneous process of law formation may be successful even in the presence of originally misaligned individual interests. The emergence of spontaneous law in both symmetrical and asymmetrical cases is considered below.

Structural Symmetry and Incentive Alignment

Perfect incentive alignment occurs when the parties' preference rankings converge toward a mutually desirable outcome. This result suggests that neither party has an incentive to defect unilaterally, nor a reason to fear defection by the other party. Such is the case of an exchange supported by a perfect contract enforcement mechanism.

The inadequacy of contract enforcement mechanisms and the possibility of post-contractual opportunism leads to the emergence of alternative contractual safeguards (Kronman, 1985). The literature on social norms proceeds in a parallel direction by focusing on non-contractual mechanisms and considering the situations that are more easily governed by spontaneous law. Under symmetrical conditions, norms that maximize group welfare also maximize individual expected payoffs. Thus, no one has any reason to challenge the emerging norm. Paradoxically, therefore, there is no need for law or norm enforcement in an environment characterized by perfect incentive alignment, as

contracts or relationships are self-enforcing (Klein, 1996).

In the presence of perfect incentive alignment, cooperation will result in both the case of repeated games in which the players are faced with high discount factors, and in one-shot games. It is worth noting that situations characterized by symmetric payoffs or role reversibility do not present an opportunity for strategic preference revelation. The expected costs and benefits of alternative rules are the same among the members of the group. Each individual has incentive to agree to a set of rules that maximize the aggregate welfare of the group, consequently maximizing his expected share of wealth. True preferences will therefore be revealed in situations of stochastic symmetry. Conversely, strategic choices are more likely to characterize real life situations with misaligned individual incentives.

Additionally, in the absence of perfect incentive alignment, the discount factor plays an important role. In situations where the probability of future interaction is relatively high, the discount factor captures two analytically distinct elements. First, it acts as a function of the players' time preference. As time preference increases, the present discounted value of future payoffs decreases. Faced with very high time preference, players in a repeat game become less likely to give up part of their present payoff for an expected increase in the payoffs from future interactions. Where time preference is infinite, payoffs from future interactions have zero present value. Second, the discount factor is a function of the probability of future interactions. When the probability of future interactions is low, players are less likely to give up part of their present payoff for an expected increase in the payoffs from future iterations. As the probability of future interactions increases, so does the present expected value of cooperation.

The discount factor's role in evolutionary models is therefore critical. Only where there is a relatively large discount factor do long-run optimization strategies become evolutionarily stable. Environments promoting a high probability of future interaction and

low time preference are therefore more likely to induce optimizing equilibria. In the case of a one-shot game, on the other hand, the probability of future interaction is zero, so that the expected value of future cooperation is also zero. (See, generally, Axelrod, 1984)

Another area of research in the customary law literature considers the role of morality and internalized obligations as a means for inducing cooperation in conflict games (see, e.g., Gauthier, 1986; and Ullmann-Margalit, 1977). Internalization of the norm is a source of spontaneous compliance. For example, individuals internalize obligations when they disapprove and sanction other individuals' deviations from the rule, or when they directly lose utility when the norm is violated. In this setting, Cooter (1994) suggests that a legal custom will successfully evolve when the *ex ante* individual incentives are aligned with the collective public interest. Cooter (1994: 224) calls this proposition the "alignment theorem." The perfect alignment of individual interests rarely occurs in real life situations, however, so proxies for structural harmony (such as role reversibility and reciprocity) must be considered.

Stochastic Symmetry and Role Reversibility

Individuals choose among alternative rules of behaviour by employing the same optimization logic they use for all economic choices. True preferences are unlikely to be revealed when individual interests are not aligned. Traditionally, strategic preference revelation is viewed as a hindrance to the spontaneous emergence of cooperation. Such a problem is likely to be minimized in situations of role reversibility or stochastic symmetry (Parisi, 1995). Similar to a Rawlsian veil of ignorance, role reversibility and stochastic symmetry induce each member to agree to a set of rules that benefits the entire group, thus maximizing her expected share of the wealth.

These conditions in fact occurred during the formative period of the medieval law merchant (*lex mercatoria*), when travelling

merchants acted in the dual capacity of buyer and seller. If they articulated a rule of law which was favourable to them as sellers, it could have the opposite effect when they acted as buyers, and vice-versa. This role reversibility changed an otherwise conflicting set of incentives (buyer versus seller) into one that converged toward symmetrical and mutually desirable rules.

The law merchant therefore illustrates a successful system of spontaneous and decentralized law (see Benson, 1989 and 1990; and Greif, 1989). Fuller (1969: 24) observes that frequent role changes foster the emergence of mutually recognized and accepted duties "in a society of economic traders. By definition the members of such a society enter direct and voluntary relationships of exchange. . . . Finally, economic traders frequently exchange roles, now selling, now buying. The duties that arise out of their exchanges are therefore reversible, not only in theory but in practice."

Certainly, the emergence of consensus for a given rule does not exclude the possibility of subsequent opportunistic deviation by some individuals when roles are later reversed. This is a typical enforcement problem, however, and the possibility of strategic defection does not undermine the rule's qualitative features. The general acceptance of or acquiescence to a custom depends primarily on its anticipated effect on the group. Those strategies that maximize the expected payoff for each participant if reciprocally undertaken evolve into norms. This conception of spontaneous law is examined by Stearns (1994: 1243-44), who observes that if the participants were unable to devise rules governing future interactions, and unforeseen circumstances placed them in a forced market relationship requiring post-contractual negotiations, courts and legislatures might have a comparative advantage over the participants in devising market facilitating rules. Unlike market participants, courts and legislatures choose from among alternative solutions as if the underlying events had not yet occurred, without attempting to strategically maximize the advantage caused by unforeseen circumstances (See also Shubik,

1987).

Where rules are breached following role reversal, norms play a collateral yet crucial role in sanctioning case-by-case opportunism. A merchant who invokes a particular rule when buying yet refuses to abide by the same rule when selling would be regarded as violating a basic norm of business conduct, and would suffer reputational costs within the business community. Conditions of role reversibility, coupled with norms that generate disincentives to adopt opportunistic double standards, are therefore likely to generate optimal rules via spontaneous processes. The group's ability to impose a sanction obviously depends on an individual's accountability for his past behaviour. Benson (1992: 5-7) explores the role of reputation in situations of repeated market interaction, observing that reputation serves as a source of collective knowledge regarding past actions.

Induced Symmetry and Reciprocity Constraints

When unilateral defection promises higher payoffs and there is no contract enforcement mechanism, players are tempted to depart from optimal strategies, often generating outcomes that are Pareto inferior for all (e.g., the well-known prisoner's dilemma game). Prisoner's dilemma-type games are plagued by the dominance of opportunistic behaviour because of the potential accessibility of off-diagonal, non-cooperative outcomes,. Schotter (1981), Lewis (1969) and Leibenstein (1982) analyze the role of conventions in correcting prisoner's dilemma situations.

Among the devices capable of correcting prisoner's dilemma-type games, the players can bind their strategic choices to those of their opponents, drastically changing the equilibrium of the game. Ensuring automatic reciprocity by binding a player's strategy to that of his opponent eliminates access to off-diagonal outcomes and renders the reward for unilateral defection unobtainable. Just as no rational player will employ defection strategies in the hope of obtaining higher

payoffs from unilateral cheating, neither will a rational player be induced to select defection strategies as a merely defensive tactic. Automatic reciprocity mechanisms thus guarantee the destabilization of mutual defection strategies and the shift toward optimizing cooperation. (For a similar argument relying on tit-for-tat strategies, see, generally, Axelrod, 1981).

Interestingly, where custom is recognized as a primary source of law, mechanisms of automatic reciprocity are generally regarded as meta-rules of the system. One may consider the following two illustrations, drawn respectively from ancient law and modern international law, which reveal substantial structural similarities.

Lawless environments are characterized by structural reciprocity. In such environments, rules of reciprocity emerge as fundamental customary norms. In the absence of an established legal system or commonly recognized rule of law, reciprocity implies that parties can do unto others what has been done to them, subject to the limits of their reciprocal strengths. Ancient customs of retaliation, based on conceptions of symmetry and punitive balance, provide an intriguing illustration of the principle of reciprocity at work. (See, e.g., Exodus 21:23; and Code of Hammurabi Paragraphs 108 and 127).

Similarly, in the so-called law of nations (the system that governs the relationships between states), the voluntary recognition of rules by sovereign states implies that absent a commonly accepted standard of conduct, lawless freedom applies. Positions that are unilaterally taken by one state generate a standard which may be used against the articulating state in future occasions.

Thus, in both ancient law and modern international law, the principle of reciprocity serves as a crucial pillar for the process of law formation. Often, situations of post-contractual behaviour capable of modifying states' obligations arise in the law and practice of international relations. The international law formation process provides states with numerous occasions for opportunistic behaviour, including hold-out strategies and free riding. Left unconstrained,

states' unilateral defection strategies would dominate in equilibrium. To cope with this reality, basic norms of reciprocity are generally recognized as rules of the game.

As a further illustration, one can consider Art. 21(1)b of the 1969 Vienna Convention, which articulates an established custom of reciprocity, creating a mirror-image mechanism in the case of unilateral reservations: "A reservation established with regard to another party . . . modifies those provisions to the same extent for that other party in its relations with the reserving state." The effects of this automatic reciprocity mechanism are similar to a tit-for-tat strategy without the need for active retaliation by states: whenever a treaty is modified unilaterally in favour of one state, the result will be as if all the other states had introduced an identical reservation against the reserving state. By imposing a symmetry constraint on the parties' choices, this rule offers a possible solution to prisoner's dilemma problems.

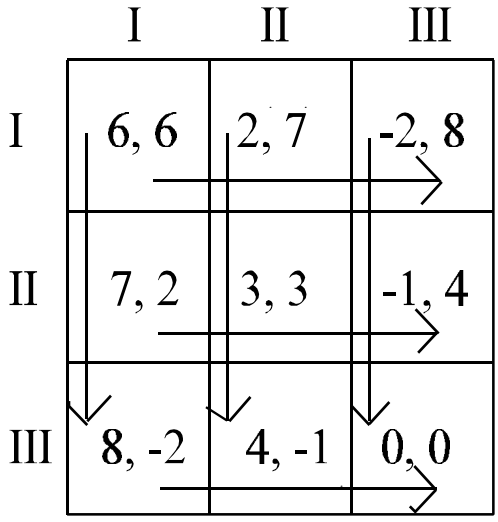

Figure (1): *A Cooperation Problem Without Constraint*

Figure (1) depicts the equilibrium obtained in the absence of a reciprocity constraint. This equilibrium should be contrasted with the outcome induced by a reciprocity constraint as illustrated in Figure (2).

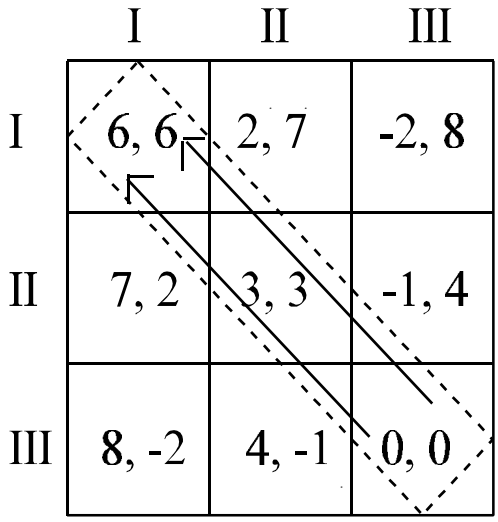

Figure (2): *A Cooperation Problem With a Reciprocity Constraint*

While the principle of reciprocity solves conflict situations characterized by a prisoner's dilemma structure (in both symmetric and asymmetric cases), alone it is incapable of correcting other strategic problems. When a conflict occurs along the diagonal possibilities of the game (such that the obtainable equilibria are already characterized by symmetric strategies), a reciprocity constraint will not eliminate the divergence of interests between the players and will not affect the results of the game. In other words, reciprocity constraints are effective only where incentives for unilateral defection are generated. For example, in a "Battle of the Sexes" game, reciprocity is ineffective. The same holds for pure conflict (i.e, zero-sum) situations. Both cases result in identical equilibria, the existence of a

reciprocity constraint notwithstanding.

Evolutionary models further examine the role of long-term relationships in the equilibrium of the game. In long-term human interactions, reciprocity and close-knittedness provide individuals with incentives to choose globally optimizing strategies. Introducing interdependent utility functions into the model, the horizons of individual maximization are extended to include payoffs from future interactions with a direct computation of the well-being of close members within the group. Such a theoretical framework obviously allows for a far more optimistic prediction of spontaneous order. This insight is consistent with the predictions of evolutionary models of social interaction, where low discount rates for future payoffs and the close-knittedness of the group are found to be positively correlated with the emergence of optimal social norms. Models based on interdependent utility and close-knittedness generate results that are qualitatively similar to those discussed for the case of role reversibility.

If the models are further modified to allow the intensity of sentiments of social approbation or disapprobation to vary with the relative frequencies of the two strategies in the population, the degree of spontaneous norm enforcement is likely to increase with a decrease in the proportion of defectors in society. Likewise, norms that are followed by a large majority of the population are more likely to be internalized by marginal individuals in the absence of coercion. Generally, if the measure of spontaneous enforcement and internalization of the norm depends on the proportion of the population that complies with the norm's precepts, the dynamic adjustment will become even more conspicuous. Along with the adjustments taking place in the initial time period, an additional "internalization effect" will occasion a dynamic adjustment of the equilibrium. An initial change in the players' level of norm internalization reproduces the conditions of instability occasioned by the initial emergence of the norm. In this setting, norms become self-

reinforcing in that they are likely to occasion an increase in both spontaneous compliance and expected payoffs to the norm-abiding players, with a threshold level of compliance marking the "tilt point" for the survival of the norm.

The various models sketched above suggest that iterated interactions with role reversibility, reciprocity constraints, and structural integration facilitate the emergence and recognition of customary law. The dynamic of the norm formation may unveil the existence of a "tilt point" beyond which emerging beliefs become stable and self-sustaining. In light of reciprocal constraints undertaken by other members of the community, individuals who frequently exchange roles in their social interactions have incentives to constrain their behaviour to conform to socially optimal norms of conduct. Buchanan (1975) insightfully anticipated this result, suggesting that even stronger logic explains the emergence of cooperation in situations of induced reciprocity. In both cases, the non-idealistic and self-interested behaviour of human actors will generate optimal norms.

Articulation Theories in the Formation of Customary Law

Notable scholars have considered the conditions under which principles of justice can emerge spontaneously through the voluntary interaction and exchange of individual members of a group. As in a contractarian setting, the reality of customary law formation relies on a voluntary process through which members of a community develop rules that govern their social interaction by voluntarily adhering to emerging behavioural standards. In this setting, Harsanyi (1955) suggests that optimal social norms are those that would emerge through the interaction of individual actors in a social setting with impersonal preferences. The impersonality requirement for individual preferences is satisfied if the decision makers have an equal chance of finding themselves in any one of the initial social positions and they rationally choose a set of rules to maximize their expected welfare.

Rawls (1971) employs Harsanyi's model of stochastic ignorance in his theory of justice. However, the Rawlsian "veil of ignorance" introduces an element of risk aversion in the choice between alternative states of the world, thus altering the outcome achievable under Harsanyi's original model, with a bias toward equal distribution (i.e., with results that approximate the Nash criterion of social welfare). Further analysis of the spontaneous formation of norms and principles of morality can be found in Sen (1979); Ullmann-Margalit (1977); and Gauthier (1986).

Legal theorists and practitioners have addressed a similar issue when considering the requirements of *opinio iuris.* In attempting to solve one of the problems associated with the notion of *opinio iuris*, namely the troublesome problem of circularity, legal scholars (notably, D'Amato, 1971) have considered the crucial issue of timing of belief and action in the formation of customary rules. The traditional approach emphasizes the awkward notion that individuals must believe that a practice is already law before it can become law. This approach basically requires the existence of a mistake for the emergence of a custom: the belief that an undertaken practice was required by law, when instead, it was not. Obviously, this approach has its flaws. Placing such reliance on systematic mistakes, the theory fails to explain how customary rules can emerge and evolve overtime in cases where individuals have full knowledge of the state of the law.

In this context, legal theorists have proposed to look past the notions of *opinio iuris* and usage concentrating on the qualitative element of "articulation." Articulation theories capture two important features of customary law: (a) customary law is voluntary in nature; and (b) customary law is dynamic. According to these theories, in the process of ascertaining the qualitative element of *opinio iuris*, relevance must be given to the statements and expressions of belief (articulations) of the various players. Individuals and states articulate desirable norms as a way to signal that they intend to follow and be bound by such rules. In this way, articulation theories remove the

guessing process from the identification of *opinio iuris*.

Consistent with the predicament of the economic models, articulation theories suggest that greater weight should be given to beliefs that have been expressed prior to the emergence of a conflict. Here, it is interesting to point out a strong similarity between the legal and the economic models. Articulations that are made prior to the unveiling of conflicting contingencies can be analogized to rules chosen under a Harsanyian veil of uncertainty.

States and individuals will have an incentive to articulate and endorse norms that maximize their expected welfare. Given some degree of uncertainty as to the future course of events, the emerging rules will be such as to maximize the expected welfare of the community at large. Conversely, rules that are articulated after an outburst of conflict may be strategically biased. Once the future is disclosed to them, parties will tend to articulate rules that maximize their actual welfare, rather than the expected welfare to be derived from an uncertain future. Thus, ex ante norms should be given greater weight in the adjudication process.

This predicament seems to be contradicted by the empirical and anecdotal evidence on commercial customary law. Bernstein (1996) examines customary rules that have developed in various modern commercial trades. Her findings seem to indicate that in the adjudication of business disputes, commercial tribunals tend to enforce customary rules that are quite different from the business norms spontaneously followed by the parties in the course of their relationship. Rather, customary rules develop around practices developed during the conflictual phase of a relationship. In this setting, Bernstein distinguishes between relationship norms and end-of-the-game norms. When adjudicating a case, courts are faced with parties who have reached the end point in their relationship. The end-of-the-game norms of the conflictual phase thus tend to be enforced, while the cooperative norms developed in the course of their relationship remain outside the domain of adjudication.

III. The Failures of Customary Law

According to the popular paradigms of economic analysis, decentralized market processes have a comparative advantage over centralized allocative mechanisms in the creation of efficient equilibria. Customary law formation can be analogized to a decentralized decision making process, with a comparative advantage over centralized processes in the creation of efficient rules.

Customary rules are generally accepted by the community, with a larger share of rules followed spontaneously by the community and a consequent reduction in law enforcement costs. In the decentralized dynamic of spontaneous law, individual decision-makers directly perceive the costs and benefits of alternative rules, and reveal their preferences by supporting or opposing their formation. The formative process of customary law proceeds through a purely inductive accounting of subjective preferences. Through his own action, each individual contributes to the creation of law. The emerging rule thus embodies the aggregate effects of independent choices by various individuals that participate in its formation. This inductive process allows individuals to reveal their preferences through their own action, without the interface of third-party decision-makers.

The analogy between customary rules and spontaneous market equilibria, however, calls for an assessment of the potential insufficiencies of the spontaneous processes of law formation. I will proceed by setting out some hypotheses for failure and discussing their potential scope of application in the area of customary law. The literature in this area is relatively thin and much work still needs to be done to develop a coherent theory of spontaneous law.

Path Dependence and the Idiosyncracies of Customary Law

Norms and conventions, vary from place to place. Any theory about the efficiency of spontaneous law should explain the diversity

of norms and conventions across time and space. In my view, there are two primary ways to provide such an explanation.

The first is to look for idiosyncratic environmental or institutional factors which might attribute to the diversity of observed rules. If the underlying social, economic, or historical realities are found to be different from one another, different norms or conventions should be expected. Rules, norms and conventions develop in response to exogenous shocks through a natural process of selection and evolution. This "survival of the fittest" explanation would suggest that whatever exists in equilibrium is efficient, given the current state of affairs. This belief, borrowed from Darwinian evolutionism, is pervasive in the law and economics literature, and, when applied to spontaneous law, risks becoming a tautological profession of faith. Ironically, we should note that the originators of such a claim, socio-biologists, have now widely refuted its validity.

The second way to reconcile the efficiency claim to the observed diversity of spontaneous rules is to consider the role of path dependence in the evolution of norms and conventions. Evolution toward efficiency takes place with some random component. Random historical and natural events (the random element of chaos theory) determine the choice of the initial path. This may be the case particularly where initial choices are made under imperfect information. Evolution then continues toward efficiency along different paths, with results that are influenced and constrained by the initial random conditions.

If we agree that path dependence has something to do with the emergence and evolution of customary law, we should follow this logic to its conclusion, revisiting the very foundations of the efficiency claim. The main question is whether path dependence could ever lead to inefficient results. According to current research (Roe, 1996), path dependence may lead to inefficient equilibria. Once a community has developed its norms and conventions, the costs of changing them may outweight the benefits. Less efficient rules may persist if the transition

to more efficient alternatives is costly. Thus, if one allows for some randomness and path dependence, norms and conventions, although driven by an evolution-toward-efficiency dynamic, may stabilize around points of local, rather than global, maximization. Our history, in this sense, constrains our present choices. We may wish we had developed more efficient customs and institutions, but it would be foolish now to attempt to change them. The claim of efficiency of spontaneous law thus becomes a relative one vis-a-vis the other sources of law. The point then becomes that of weighing the relative advantages of spontaneous law-making against the attributes of engineered legislation, taking full account of the pervasive public choice and information problems underlying such alternatives.

Rational Abstention and Norm Manipulation

A public choice analysis of customary law should consider the vulnerability of norms and customs to the pressure of special interest groups. This line of analysis—relatively undeveloped in the current literature—should search for parallels between the legislative process and the dynamic of norm formation. In that setting, the opportunity for collective beliefs and customs to be manipulated by special interest groups should be analyzed. Any claim that customary sources are superior to proper legislation will have to rest on a solid understanding of the relative sensibility of each source to possible political failures.

The application of a well known theorem of public choice to the study of customary law generates very interesting results. Unlike legislation in a representative democracy, customary law rests on the widespread consensus of all individuals affected by the rule. If principal-agent problems are likely to arise in a political world characterized by rational ignorance and rational abstention of voters, no such problems appear to affect customary sources. Individuals are bound by a customary rule only to the extent that they

concurred—actively or through voluntary acquiescence—in the formation of the emerging practice.

Imperfect information, however, may induce voluntary acquiescence—or even active concurrence—to an undesirable practice. Economic models of cascade or bandwagon behaviour have shown how inferior paths can be followed by individuals who rely on previous choices undertaken by other subjects, and value such observed choices as signals of revealed preference. Economic models have shown that, when information is incomplete, excessive weight can be attached to the signal generated by others. Others' choices may be followed even when the agent's own perception conflicts with the content of the observed signal. In this way, a biased or mistaken first-mover can generate a cascade of wrong decisions by all his followers, with a result that may prove relatively persistent under a wide array of conditions.

Cascade arguments may also unveil the relative fragility of spontaneous sources of law in light of the possible manipulation of collective beliefs through biased leadership. If information is imperfect, the input of politically biased first-movers may generate undesirable norms. These norms may persist because of the weight attached to the choices of our predecessors. Thus, once generated, wrong beliefs may become stable and widespread in any community of imperfect decision makers.

Collective Action Problems in Customary Legal Regimes

Another potential weakness of customary law is revealed by the application of a collective action framework to the study of the formation and enforcement of customary rules. We can start the analysis by observing that legal rules and law enforcement are public goods. In the case of customary rules, collective action problems may thus arise at two distinct stages: first, in the formative process of customary rules; and second, in the enforcement of the emerged

customs.

The process of a custom formation relies on the spontaneous and widespread acceptance of a given rule by the members of a group. Individuals often face a private cost when complying with the precepts of the rule, and they generally derive a benefit because of the compliance of others with existing rules. Thus, the formation of customary law can be affected by a public good problem. When discussing the conditions under which customary rules can effectively develop, I illustrated the analysis with a game-theoretic framework. The public good problem considered here is in many respects similar to the strategic tension that we have examined in the context of customary law formation. If individuals face a private cost and generate a public benefit through norm creation, there will be a suboptimal amount of norms created through spontaneous processes. Any individual would like others to observe a higher level of norm compliance than he or she observed. The resulting level of norm compliance would thus be suboptimal. Collective action problems in the formation of customary rules have traditionally been corrected by norms which sanctioned opportunistic double standards, and by metarules imposing reciprocity constraints on the parties.

More serious collective action problems emerge in the enforcement of spontaneous norms. If the enforcement of norms is left to the private initiative of individual members of the group, a large number of cases will be characterized by a suboptimal level of enforcement. Punishing violators of a norm creates a public good because of the special and general deterrent effect of the penalty. Yet imposition of the penalty is left to private initiative, punishers would be willing to enforce norms only to the point which the private marginal cost of enforcement equals its private marginal benefit. This equilibrium obviously diverges from the social optimum, where enforcement would be carried out until the marginal cost equals the social, rather than private, marginal benefit.

This consideration explains why the customs of ancient societies

recognized and sanctioned only a limited category of wrongs. Generally speaking, only those wrongs that had a well-identified victim were likely to be addressed through a system of private law enforcement. For the system of private law enforcement to function properly, it was necessary for the victim or his clan to have a strong interest in carrying out the punishment. This also explains why other categories of wrong with a broader class of victims tend to emerge during more advanced stages of legal development, when law enforcement is delegated to a central authority.

In sum, collective action problems may be pervasive in the enforcement of customary rules, with a consequential risk that enforcement will be suboptimal. This conclusion suggests that the decentralized process of law formation may be successfully coupled with a centralized mechanism of law enforcement. In this way, the advantages that customary sources have in gathering diffuse information will be available, free from the collective action problems that typically affect decentralized processes of law enforcement.

Adjudicating Social Norms

According to the theory of spontaneous law, customary law has a comparative advantage over the other institutional sources. The intellectual basis of this claim is related to the proposition that any social arrangement that is voluntarily entered upon by rationally self-interested parties is beneficial to society as a whole.

The inductive process which underlies spontaneous law builds upon the role of individuals giving direct effect to their revealed preferences, without the interface of third-party decision-makers. To the extent that social practices have emerged under competitive conditions (i.e., so long as there is an implicit cost for indulging in inefficient equilibria) without Pareto relevant externalities, we may be able to draw plausible conclusions regarding the desirability of emerging customs. It is in this latter sense that custom may reclaim

full dignity as a source of law. The evolutionary and game-theoretic appraisals of the lawmaking process have indeed shed new light on the normative foundations of spontaneous law, but they require an appropriate analysis of the incentive structure in the originating social environment. (Cooter, 1992).

Evolutionary theories of cooperation have indeed explained the ability of rationally self-interested individuals to cooperate for the sake of mutual gain. Evolutionarily stable cooperative strategies serve efficiency goals and may emerge as social norms recognized by the community to be obligatory. Once emerged, customary rules generate the expectations of the other members of society and those expectations in turn demand judicial enforcement. In some instances, peer pressure and spontaneous processes of norm internalization will support their enforcement.

The legal system may further this process by recognizing and enforcing welfare-maximizing social norms. In this regard, Cooter (1994) argues that legal recognition and enforcement should consequently be denied in the case of non-cooperative practices, under a test that amounts to a structural analysis of the social incentives that generated the norm. He further argues that in the process of common law adjudication, a distinction must necessarily be made between cooperative norms and non-cooperative practices. Courts are not specialized in the adjudication of most norms. They must therefore resort to a structural approach, first inquiring into the incentives underlying the social structure that generated the norms, rather than attempting to weigh their costs and benefits directly.

Local Information and Evolutionary Traps

When the private incentives of the parties diverge from the collective good and the parties cannot enter into binding and enforceable social contracts, inefficient social interactions may follow. These situations may generate suboptimal Nash equilibria as the

benefit pursued by each individual player is insufficient to compensate for the harm suffered by the other players. While at times benefitting a few members of the group, strategies of this kind may result in a net social loss for the collectivity. Generally considered undesirable, they may be condemned from the other members of the group. In this way, rules that are expected to harm the aggregate well-being of the community will not be supported by a belief of social necessity. By discouraging the adoption of socially suboptimal strategies, the group ethic may serve to destabilize undesirable stalls in the evolutionary process. Therefore, those societies that foster a strong group ethic will maintain a comparative advantage over others. Whenever the societies operate in an intergroup environment marked by strong competition, competing societies will adopt the norms of societies with the comparatively strong group ethic, or else they will suffer negative selection.

A group ethic will evolve to the extent that it corrects evolutionary stalls and restabilizes of the flow toward global maximization (Hirshleifer, 1982). Figure (3) illustrates a possible scenario for an evolutionary trap. Because the non-convexity of the preference set does not permit a progressive shift from B to A without a utility loss, the point of local maximization B may be characterized as an evolutionary trap. These situations could be termed “no pain, no gain.” They are representative of cases where individuals are at a point of local maximization and–because of imperfect knowledge or perhaps inertia in their consumption or behavioural habits–are unlikely to shift to a different optimizing point without external incentives. Imperfect information, in this context, implies that individuals may have complete information about where they are, but not necessarily about where they are going-such that the preferences that are revealed through the observed choices of the parties may not be used as an absolute proxy for individual optimization.

When this type of evolutionary stall persists in a group, social norms of acceptable behaviour may emerge (Levy, 1988). Those who

depart from these norms may be subjected to sanctions (condemnation).

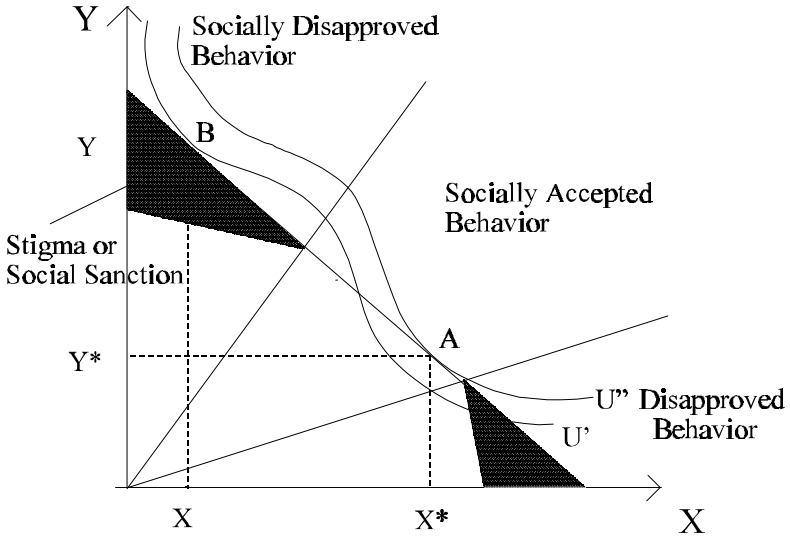

Figure (3): *The Utility-Enhancing Norm*

Despite the general economic motion which views constraints as "bads" for optimization problems, Figure (3) shows possibility of a utility-enhancing constraint capable of correcting a suboptimal equilibrium obtained in a point of local maximization along a non-convex preference set.

Within a local optimization setup, moral constraints may supply information not otherwise revealed by the local surface. Together with social norms and group standards, moral constraints transmit the accumulated wisdom of past experience to individual decision-makers. In this framework, norms of tradition, morality, and group ethics do not conflict in any general way with the economic paradigms of

efficiency and optimization. Evolution assures that practices which are socially inferior (in the sense that they do not make a cost-justified contribution to human well-being) are less frequently adopted because they are labelled as immoral, socially inappropriate, or ethically wrong. Of course, evolutionary processes are never completed, and their task is only stochastically accomplished. Still, the strong correlation between activities and institutions that are efficient, and the community's moral approval of them, should not be underestimated. Many activities that are generally considered immoral (e.g., stealing, cheating, lying, etc.) are also inefficient in that they dissipate human wealth. While counter-examples exist in which "morally condemned" behaviour actually contributes to overall human welfare, social norms and moral principles of the type described above should be considered "rules of thumb" principles of conduct for individuals who operate in a world of imperfect information and limited cognitive competence (See, Heiner, 1983; Frank, 1988; and Parisi, 1995).

IV. Conclusions

The bulk of law and economics literature focuses on the role of markets as an alternative to the political process for achieving social order. The literature on customary law and spontaneous norms extends the domain of traditional law and economics inquiry to include both the study of the influence of market and non-market institutions (other than politics) on legal regimes, and the study of the comparative advantages of spontaneous and decentralized processes in supplying efficient rules. Current research is appraising the ever-changing boundaries between social norms and legal rules and investigating the public choice implications of the formative process of spontaneous law. Undoubtedly, social norms and customary law should be evaluated in light of possible bias in the formation of social convictions and individual values, just as traditional confidence in

legislation has been reappraised in light of the failures of the political process.

List of Statutes and Laws

Code of Hammurabi, Para. 108, 127.

Exodus 21:23.

Restatement of the Law - Foreign Relations Law of the United States, Sec. 102.

Statute of the International Court of Justice, Art. 38(1).

Vienna Convention, Art. 21(1)b.

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