PATH DEPENDENCE IN THE DEVELOPMENT OF PRIVATE ORDERING

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INTRODUCTION

Private legal systems (PLSs) are institutions that enforce norms and that are not affiliated with government, that is, with entities that have sovereign power. PLSs range from informal institutions that bear little resemblance to the public legal system (the law), such as norms of politeness, to ones that are very similar to the law, such as complex commercial arbitration among diamond dealers.

Scholarship on PLSs tends to focus on two questions, both related to the norms that PLSs enforce: what are the norms that PLSs enforce,¹ and are these norms more or less efficient than those of the law.² There is far less concern as to how PLSs form and how they develop the ability to enforce norms. Perhaps due to this focus on norms, much of the literature assumes that PLSs emerge autonomously in response to governance needs that are unfulfilled by government.

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Yet an observation of successful PLSs—ones that, like the public legal system, enforce on a large and heterogeneous population norms that are adversarial—suggests that many of these PLSs rely on a core collaborative norm—most commonly one that provides religious or social identity.

Consider, for example, *Pax Dei* (Peace of God), a movement in tenth and eleventh century Western Europe to protect defenseless peasants, among others, from feuding warlords:

> The peace of God was . . . a substitute for the peace of the king. Nothing more. It changed nothing in the framework of peace . . . . The only difference was this: the place formerly occupied by the king was now taken by that which on earth most nearly approached the divine, the holy remains, piled high for the occasion in reliquaries withdrawn from every crypt in the province.

The norm did not change; the enforcement mechanism did. The *Pax Dei* norm was a challenging one to enforce, since it was adversarial in nature—each individual warlord had much to gain by violating it while other warlords abided by it—and applied to a large number of warlords with different preferences, some who may prefer less violence, others who may benefit from more upheaval. When the public legal system—the king—proved ineffective in enforcing the norm, the peasants turned to private enforcement that relied on religion.

An examination of successful PLSs finds that they very frequently rely on religion, kinship, or social ties. Medieval craft guilds provide a second example:

> Many craft guilds seem to have originated as religious fraternities whose members were drawn together by ties of common devotion. The starting point of the Mercers’ gild at York, for example, was a license given in 1357 to merchants, mercers, drapers, hosiers and dyers to organize a fraternity for religious and social purposes. In most cases the fraternity, that is, the gild in its religious and social aspects, was no doubt merged with the mistery, that is the gild in its industrial aspect . . . . Bound together by their common calling in the pursuit of common aims, the medieval craftsmen developed an ideal of co-operation and joint effort which gained in intensity what it may seem to have lacked in range of vision.

Other successful PLSs rely on non-religious social identity. Robert Ellickson describes how ranchers in rural California are deterred by the threat of spreading negative gossip from allowing their cattle to trespass on

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3. The degree to which a norm is adversarial is the degree to which participants have an incentive to violate the norm; in other words, it is the cost of compelling compliance with the norm, leaving constant environmental factors (e.g., the number of members, the homogeneity of their preferences, and the fluctuation in membership). A collaborative norm is on the far non-adversarial end of the spectrum (i.e., has low enforcement costs).


farmers' lands. Ellickson explains that gossip is an effective deterrent, and one preferable for the injured party to suing the offender, “because only the extreme deviants are immune from the general obsession with neighborliness.” Janet Landa examined long-distance trading of rubber in Singapore and West Malaysia in 1969 and concluded that trading was made possible, despite significant information asymmetry and ineffective government enforcement of contracts, because of trust facilitated by ethnic relations between the traders. Similarly, Avner Greif finds that long-distance trading in the Mediterranean in medieval times was facilitated by ethnic and religious ties of Maghribi Jewish traders.

This Article explains why successful PLSs rely on these core, cooperative norms, and develops a theory on the development and norm selection of PLSs. In doing so, this Article heavily relies on, revises, and expands my earlier work. In a nutshell, cooperative norms provide PLSs with a competitive advantage, in the form of lower enforcement costs, over rival legal systems, and this advantage is difficult for rival PLSs to imitate. The enforcement costs of a new norm are reduced if the PLS is already enforcing some norm on the same members that are to be subject to the new norm, because the PLS can compel compliance with the new norm by denying a member the benefits of the already-enforced norm.

But how would a PLS enforce the preexisting norm? By beginning with a core norm that has very low enforcement costs, a cooperative norm that provides religious or social identity. Once this core has developed, PLSs may choose expansion norms that can be more expensive to enforce, with each successful expansion increasing the value of membership and therefore reducing enforcement costs, allowing for enforcement of even costlier norms.

The Article will proceed as follows: Part I defines PLSs, explains how they enforce norms, how they differ from other norm enforcing institutions, and what conditions enhance their effectiveness in enforcing norms. Part II considers rival theories on what drives the development of PLSs (autono-

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mous formation vs. path dependent formation), and explains why relative advantage in enforcement costs, rather than in norm efficiency, determines which PLS succeeds in enforcing norms. It then applies this insight to describe the pattern in which PLSs develop: first facilitating a non-adversarial core norm, then gradually adding layers of increasingly adversarial expansion norms, using the value that the core norm and successfully enforced expansion norms provide members to compel members’ compliance with new expansion norms. Part III considers the role of shared identity in norm enforcement, highlighting a challenge to path dependent formation from an area that has been ignored by PLS scholars: the “invention of tradition” to artificially produce shared identity.

I. WHAT ARE PRIVATE LEGAL SYSTEMS?

A. PLS Enforcement Mechanisms

I define a PLS as a multi-party institution that enforces norms on its members through the use of network effects. This distinguishes PLSs

11. I use the terms “members” and “PLS members” to refer to individuals or firms who are subject to the norms enforced by the PLS. The broader group of “participants” or “market participants” is people who could potentially be PLS members and who may currently be members of another PLS, another norm enforcement institution, or not currently subject to any norm enforcement institution.

12. I prefer this definition to an alternative one that focuses on the non-government (i.e., private) character of the institution, because the dichotomy between public and private legal systems is not always a clear one. Some PLSs have a significant public backing and are very similar to public legal systems. For example, as Zywicki describes, the King of England enacted in 1353 the “Statute of the Staple,” which prohibited Common Law courts from hearing disputes arising from contracts made on the staple markets (markets for important commodities, such as wool). Instead, the statute created Staple Courts and instructed them to apply the privately-formed law merchant. Thus, private law was given exclusive jurisdiction by public decree. Zywicki, supra note 2, at 1598-1599.

I also prefer a definition that focuses on network effects to one that focuses on the competitive environment of the institution (i.e., PLSs compete against each other while public legal systems enjoy a monopoly). Some public legal fora compete with other legal fora. For example, the common law developed in England from the rulings of judges of the Court of King’s Bench. For centuries this court had competed with several other royal courts (notably the Court of the Exchequer and the Court of Common Pleas), the ecclesiastical courts, town and feudal courts, and merchant courts. Though the courts had, in theory, limits to their jurisdictions, they each used legal fictions to expand their reach. Zywicki, supra note 2, at 1582-1588. Similarly, today, American companies can incorporate in any of the states, and that state’s corporate laws will apply to them. Much scholarship has examined the competition between states that results. E.g., William Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L. J. 663 (1974); Ralph Winter, State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. LEG. STUD. 251 (1977). The enforcement mechanisms of, say, the Delaware Court of Chancery, bear a lot of resemblance to other, monopolistic, public legal systems, and very little resemblance to PLSs. Thus, I find
from other norm enforcing institutions, notably government regulation (which relies on government’s monopoly on legitimate force), and bilateral contracts (which rely on either government enforcement or the bilateral exchange of collateral, but not on network effects).

Network effects provide three mechanisms to enforce norms on members.\footnote{Aviram, Networks, supra note 10, at 1204-1211.} The “exclusion mechanism” is the ability to deter and punish norm violations through expelling a member and enforcing a boycott by PLS members of the offending former member. Network effects galvanize this mechanism because the larger the number of members and the greater the amount of interaction among PLS members, the greater the value of membership, which is lost upon expulsion.

The “control mechanism” utilizes the PLS’s facilities to prevent norm violations, by structuring the facilities so that they force certain desirable behavior, prevent undesirable behavior, or collect information that enables detection of undesirable behavior.\footnote{In Aviram, Networks, supra note 10, I distinguished between the control mechanism, which used PLS facilities to encourage or discourage certain behaviors, and the information mechanism, which used PLS facilities to detect norm violations. I now believe there is no justification to distinguish these two functions of employing network facilities to enforce norms, and therefore consider what I used to call the information mechanism as a subset of the control mechanism.} For example, a PLS can use its possession and ownership of a shared facility, such as a guildhall, or an online social network’s servers, to force members to act in desirable ways or to detect member behavior that violates the PLS’s norms. It may structure a shared physical space or the software used by members to interact so that it forces parties to interact in a way compliant with the PLS norms. Network effects galvanize this mechanism because the greater the amount of business transacted through PLS facilities, the more indispensable those facilities are to members, and therefore the more the members need to transact through these facilities, under the PLS’s watchful eye and subject to facility designs that encourage norm compliant behavior.

Finally, the “switching mechanism” reduces the likelihood of a hold-up problem by making available to members alternative counterparties. In other words, the switching mechanism shifts relationship-specific investments from the relationship with a particular party to the relationship with the PLS. For example, suppose that Ann agrees to buy from Bob, for $100, tickets to a Wimbledon tennis match. Relying on the agreement, she purchases plane tickets to London. Bob then demands $200 for the match tickets, or he will renege on the deal. Ann may well agree, in order to salvage the value of her plane tickets. But if the purchase takes place on an online marketplace, there are likely numerous other match ticket sellers; even if
Bob was the cheapest, Ann could probably get a ticket for under $200. Knowing this, Bob would likely not act opportunistically in the first place.

B. PLSs vs. Bilateral Contracts

Because I define PLSs as multi-party institutions that rely on network effects, I need to distinguish them from another private norm enforcer: bilateral contracts.

Bilateral contracts are enforced by bonding. Bonds are interests of an assuring party that are placed at the mercy of an assured party, such as collateral. The assured party can confiscate or destroy a bond at will, causing harm to the assuring party. The bond should deter the assuring party from defaulting on an obligation, since a default could cause the assured party to confiscate the bond. To mitigate the risk that the assured party would opportunistically confiscate the bond without justification, and to guarantee reciprocal obligations when a transaction involves obligations from both parties, bonds can be exchanged.

Bilateral bonding is an expensive enforcement system, and often a crude one. Non-reciprocal bonding (i.e., providing a bond without receiving one) leaves the party offering the bond vulnerable to the other party’s ability to confiscate the bond without cause. Reciprocal bonding is subject to reciprocal confiscation, which may leave both parties worse off, but not by enough to deter an opportunist. For example, suppose that Jack agrees to sell to Jill his share of Acme stock for $10. In order to bond each other into

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15. The public legal system typically creates such bonds by default, through contract law. Each party to an enforceable agreement can petition to use the state’s enforcement machinery to enforce the other party’s obligations. In some cases, criminal law may also intervene. When bilateral contracts are enforced by courts, they share the traits of government regulation. For example, they can benefit from government’s monopoly on legitimate violence in enforcing a judgment. But they are also limited by government’s norm selection and enforcement priorities. For example, a contract may be deemed unenforceable as against public policy, or it may be enforceable in theory but not in practice because the judicial process is slow and expensive. Thus, to the extent that bilateral contracting relies on government enforcement, it is not an alternative to government regulation, but a form of it.

16. Oliver Williamson calls this practice an “exchange of hostages”. Oliver Williamson, Credible Commitments: Using Hostages to Support Exchange, 73 Am. Econ. Rev. 519 (1983), citing Thomas Schelling, An Essay on Bargaining, 46 Am. Econ. Rev. 281, 300, at footnote 17 (1956). In fact, a literal exchange of hostages was among the early forms in which this mechanism was used to assure commitment to peace treaties. Gregory of Tours describes the use of this mechanism in the year 511: “But Theoderic and Childebert entered into a treaty and each took an oath that neither would wage war upon the other. They took hostages so that they might the more firmly adhere to what they had promised. Many sons of senatorial families were thus given.” Gregory of Tours, Enslaving Noble Families, in 71 Patrologiae Cursus Completus 255 (J.P. Migne ed., 1849), reprinted in Roy C. Cave & Herbert H. Coulson (eds.), A Source Book for Medieval Economic History 288-89 (1965).
performing their contract, each gives the other $100 in cash as collateral. When Acme’s share price drops to $5, Jill reneges on the agreement. When Jack retaliates by confiscating Jill’s collateral, Jill can confiscate Jack’s collateral, so that the bonds will offset each other without deterring Jill.

Given this weakness, instead of reciprocal bonding a party can provide asymmetrical collateral: a bond that harms one party without providing the other party with any utility. A hostage exchange is one such example: killing a hostage harms the hostage’s kin but does not directly benefit the murderer. Likewise, if person A sullies B’s reputation, then B is harmed while A does not receive any benefit. If A were seen to benefit from the harm to B’s reputation, the credibility of A’s negative information about B would be undermined.

But even with asymmetrical collateral there is a risk of insufficient deterrence. First, destroying collateral upon suffering a perceived offense may be rational, even when the destruction of the collateral is not profitable, because such destruction enhances deterrence: it indicates that the same action may be taken again in the future if another offense is perceived.17 But while excessive sensitivity may provide increased deterrence, it also risks undoing a bond. Each party has an incentive to react to minor slights in order to deter the other party from attempting even minor opportunistic behavior at his expense. Therefore, parties may overreact, confiscating the bond at the first perception of an offense in the hope of greater deterrence of the other party in future transactions. But once a bond is confiscated, that other party is likely to retaliate by confiscating the bond it holds, eliminating the assurance mechanism, and increasing the likelihood of a cycle of opportunistic—or outright malicious—behavior.

Second, collateral designed to be costly to one party but useless to the other party may be handled in ways that create utility to the latter party. For example, rather than killing a hostage, the hostage may be enslaved, providing the enslaving party with utility.18 Likewise, collateral useless to the possessing party but useful to a third party may be traded to the third party.

Third, the value of the collateral is often hard to determine. Collateral deters only opportunistic action that is no more profitable than the collateral’s value; otherwise, its owner would find it profitable to commit the opportunistic act, pocket the gain, and accept the loss of the collateral. Since


18. This is precisely what happened in the hostage exchange between Theoderic and Childebert, mentioned supra note 16. Gregory of Tours describes: “[B]ut when a new quarrel broke out between the kings [the hostages] were reduced to servitude.... And those who had taken care of them now made slaves of them.” Besides deriving utility from the hostages, enslaving them (rather than killing them) may be intended to inflict some harm on the hostage’s kin, while maintaining future deterrence through the ability to inflict additional harm by killing the hostages. Gregory of Tours, supra note 16.
gains from opportunistic behavior vary widely, it is hard to anticipate the optimal value of the collateral, and almost any value of collateral would fail to deter some extremely profitable opportunistic behavior. Furthermore, since parties exchanging bonds differ in the degree to which each is vulnerable to the other party’s opportunism, and in the loss of utility they suffer in providing the bond, parties might disagree on the optimal value of the bond.

Fourth, providing collateral is costly even when it is not confiscated because of its opportunity cost: a work of art given as collateral does not bring joy to its owner while it is held by others; an asset used as collateral for a transaction with one party is unavailable or less valuable to secure obligations with other parties.\(^\text{19}\) These costs create an incentive to reduce the size of the collateral as much as possible.

To summarize, bilateral contracting that relies on government enforcement is a form of government regulation, sharing its advantages and disadvantages. Bilateral contracting that does not rely on government enforcement is costly and likely to be displaced by a PLS, if an effective one can develop.

C. Effective PLS Design

Most PLSs employ a centralized bonding mechanism that uses as collateral certain intangible assets, such as the right of membership in the PLS, members’ reputation, or access to a personally or economically significant location (a holy shrine, the floor of an exchange, etc.). “Confiscating” this collateral means expulsion from the PLS, tarnishing a member’s reputation, or denying access to locations significant to the member.

To overcome the problems that plague bilateral bonding, a PLS ideally forms a centralized bonding mechanism with the following features: (1) an independent party—the PLS—holds the collateral of all members and has control over its confiscation; (2) the collateral does not lose utility by being controlled by the independent party; (3) the independent party does not profit from opportunistically confiscating the collateral;\(^\text{20}\) and (4) the expected cost to a member from the confiscation of the collateral is greater than the expected profits from defaulting on the norm.

Element (1) eliminates the risk of retaliation confiscations, such as between Jack and Jill in the above example, and also places the confiscation decision at the hands of a repeat player—the PLS—who may suffer if its decisions are arbitrary. Some PLSs, such as common social courtesy, are

\(^{19}\) Even intangible collateral such as reputation loses its value to counterparty 1 if counterparty 2 “confiscates” it (i.e., sullies the defaulter’s reputation). Therefore, reputation loses value as collateral the more counterparties are able to “confiscate” it.

\(^{20}\) This feature requires that remaining members do not profit from excluding the expelled member.
decentralized, lacking a controller who decides whether to confiscate the collateral. When PLSs expand to enforce more adversarial norms, they are likely to develop a centralized body of officials who investigate suspected norm violations and are authorized to exclude offending members, with their decision binding on all members. Another structural development is a secondary boycott norm that excludes members who continue to interact with the excluded member. Finally, the greatest control over confiscating the collateral is obtained if the PLS can direct all PLS transactions through a common essential facility that is managed by the PLS, such as a common room, trading floor or computer system used by the members to transact their common business. This allows the PLS to affect an expulsion by denying a member access to the facility, without having to rely on members’ adherence to its decision.

Element (2) reduces the costs of providing the collateral. Unlike many physical assets, the common collateral used in PLSs—a right of membership in a PLS, one’s reputation among the PLS members, access to a personally or economically significant location—does not lose value from being controlled by the PLS.

Element (3) addresses the risk of opportunistic confiscation of the collateral. The collateral in a PLS is usually asymmetrical (a member gains from having it, the PLS does not gain from taking it), because a PLS would lose some network effects by excluding a member. However, because PLS members often compete in certain spheres, occasionally some members would gain more from eliminating another member than they would suffer from the reduction in PLS network effects if that member were eliminated— a strategy called “degradation”.21 This would typically occur when there are few members, and thus the weakening or elimination of one gives others a significant advantage, and when the PLS provides sufficiently significant benefits, so that the expelling a member would significantly weaken it. When PLS members benefit from an opportunistic expulsion of another member, the PLS is less effective in enforcing norms.

Element (4)—that a member’s loss from expulsion is greater than the benefit from violating the norm—is required for the threat of confiscation to deter a potential norm violator. This depends on the benefit from violating the norm (i.e., how adversarial the norm is) and on the benefit a member derives from association with the PLS. Newly-formed PLSs have yet to provide utility, and therefore expulsion from the newly-formed PLS is not costly. Some incumbent PLSs also provide low utility to members, either because the benefits they already provide are not sufficiently great to sur-

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pass the benefits of violating an adversarial norm, or because they cannot effectively exclude a member.\textsuperscript{22}

The first three elements are a matter of PLS design. A PLS could fulfill them from the moment it was created. The fourth element, however, distinguishes incumbent PLSs from new ones: the expected cost to a member from being punished by the PLS depends on the effectiveness of the three enforcement mechanisms that were described in Part I.A. The effectiveness of these mechanisms depends, in turn, on the network effects produced by interactions within the PLS. Thus, incumbent PLSs can be expected to have lower norm enforcement costs than newly formed ones. Part II explains how this characteristic leads to a particular pattern of PLS development: path dependent formation.

II. PATH-DEPENDENT FORMATION OF PLSs

A. Two Theories on the Evolution of PLSs

At a high level of abstraction, there are two alternative theories for the evolution of PLSs that differ over the main factor over which potential PLSs compete, success in which allows the PLS to survive. One might view them as a demand-side theory, which focuses on the norm’s efficiency (i.e., the benefit to members from the enforced norm that indicates members’ demand for enforcing the norm), and a supply-side theory, which focuses on the PLS’s efficiency in enforcing (supplying) the norm.

The first theory, which I call autonomous formation,\textsuperscript{23} views PLS evolution as competition between potential PLSs over the efficiency of the norm they enforce. Potential PLSs experiment with various norms, and the surviving PLSs are the ones that successfully identify “efficient” norms—in the sense of maximizing the welfare of the PLS’s members—and demonstrate their ability to efficiently enforce these norms. The inability to exclude a member may either be due to the PLS needing the member more than the member needs the PLS, or due to structural limitations of the PLS in ensuring all members complied with the decision to exclude a particular member. A social group, for example, may rely on negative gossip to ostracize a member. However, the PLS can only disseminate the negative gossip; the decision to ostracize is taken by each member individually.

By “autonomous formation,” I mean the creation of a PLS without reliance on a preexisting norm enforcing institution. I claim that a PLS rarely forms without reliance on a preexisting foundation, and that this preexisting foundation is almost ubiquitously a collaborative norm—typically one that provides religious or social identity. Because much of the private ordering literature focuses on the lack of reliance on government, one may mistakenly interpret autonomous as “independent from government,” but this is not the meaning I intend. In challenging the notion of autonomous formation, I do not dispute that PLSs can, and frequently do, form and evolve without relying on government actions, but they very rarely form and evolve without relying on some preexisting norm enforcing institution, be it government or a preexisting PLS.
this efficiency to the members. In this world, incumbent PLSs do not have a significant advantage over newly-formed PLSs, because incumbency does not typically increase the ability to devise more efficient norms. Indeed, incumbent PLSs are likely disadvantaged relative to newcomers if either: (1) norms they already enforce are at odds with a newly-devised efficient norm, and thus the incumbent would not want to enforce the new norm; or (2) the efficient scope of the new norm does not overlap with an incumbent PLS’s membership. Thus, if PLSs live and die by the efficiency of the norms they devise, then we should expect an almost random pattern of PLS development, in which new PLSs autonomously form as they identify an efficient norm. In this world, a new norm is likely to be enforced by a new PLS.

The second theory, which I call the path dependent formation, views PLS evolution as competition between potential PLSs over the cost of enforcing the norm. Under this theory, PLSs with high enforcement costs cannot credibly assure participants that they will be able to enforce the norms they espouse, but PLSs with lower enforcement costs can. Faced with a choice between a low probability of enforcing the most desirable norm and a high probability of enforcing a less desirable, but still somewhat beneficial, norm, participants are likely to grudgingly throw their lots with the latter.

As explained below, a PLS’s incumbency significantly reduces its enforcement costs. As a result, and contrary to the autonomous formation theory, a new norm is likely to be enforced by an incumbent PLS, and a small number of PLSs expand and control most private norm enforcement over a given group of participants. The main check on the growth of PLSs, which prevents a single PLS from enforcing all norms, is that a PLS’s enforcement mechanisms are effective against only its members. To enforce norms that require the cooperation of a different set of actors, the PLS must expand its membership. This expansion in turn increases the heterogeneity of member preferences, which increases the costs of enforcing all PLS norms, including ones already enforced. To avoid diminishing the effectiveness of its norm enforcement, which might open the door for a competing PLS to step in, an incumbent PLS will likely forego enforcing norms that require significant membership expansion.

Since the enforcement of a new norm is likely to be in the hands of an incumbent PLS, and since the PLS has some discretion over the content of

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24 A new PLS could select its members so as to fit the efficient scope of the new norm, while an incumbent PLS would be forced to modify its membership if it wishes to also enforce the new norm.
the norm it enforces, the norms enforced today depend on the PLSs that existed yesterday—hence a path dependent formation.25

B. Assessing PLS Enforcement Costs

While the literature on PLSs has not developed a framework for assessing norm enforcement costs, another body of legal and economic scholarship has addressed this issue in great depth: the antitrust literature addressing cartel sustainability.26 Cartels are norm enforcers that enforce a particular, highly adversarial norm: the maintenance of above-market prices or the delineation of markets between cartel members. Since George Stigler’s seminal article,27 the literature on cartel sustainability has focused on the cartel’s enforcement costs. Sustainable cartels have lower enforcement costs due in large part to homogenous preferences of members (which results from homogeneous products and stable market demand), a small number of members with a high aggregate market share, high barriers to entry, and little or no competition with rival cartels. These factors affect enforcement costs of other PLSs.

However, the utility to PLS scholars from the literature on cartels is limited because the cartel norm is so adversarial. The benefit from defecting from a cartel is so great that in most circumstances, cartels can be enforced only in extremely benign environments, involving a small number of members with homogenous preferences and high barriers to entry. When this benign environment deteriorates, cartels tend to collapse.

In contrast, the PLSs that most resemble the public legal system have a large number of members with heterogeneous preferences, and barriers to entry are low (in the sense that many individuals may migrate into the geographical or social sphere in which the PLS operates). PLSs are able to enforce norms in such harsh environments because of their ability to rely on government institutions and particularly on government’s monopoly on legitimate force.

The cartel literature would predict that in this harsh environment private enforcement is unsustainable, yet this prediction conflicts with the existence of PLSs such as the medieval craft guild (which enforced, among other things, a cartel norm) or Pax Dei (which enforced limits on warfare—an even more adversarial norm than a cartel). PLSs are able to enforce such


27. Stigler, id.
adversarial norms in harsh environments because they begin by enforcing less adversarial norms and only later expand into more adversarial norms. As a result, many PLSs become more sustainable over time as they expand to enforce more norms, in contrast to narrow cartels, which tend to become less sustainable over time.\textsuperscript{28}

To the main factors mentioned in the antitrust literature as determining enforcement costs—homogeneity of member preferences, number and aggregate power of members relative to participants (market share, in the antitrust context), and barriers to entry as a participant—we should add an additional factor: how adversarial the norm is. The degree to which a norm is adversarial is not a factor explored in cartel literature because that literature focuses on just two adversarial norms: price fixing and market allocation.\textsuperscript{29} The broader world of PLSs ranges from non-adversarial norms to highly adversarial ones. The enforcement of less adversarial norms can succeed in harsh environments in which autonomous enforcement of cartels would be impossible.

C. Incumbency and the Paradox of Autonomous Formation

As the literature on cartels predicts, the fact that a highly adversarial norm is efficient for its members is not sufficient to sustainably enforce the norm in harsh environments characterized by a large number of members, low barriers to becoming participants, and heterogeneous member preferences. This is due to a “chicken and egg” paradox, which I call the paradox of autonomous formation: to enforce a norm efficiently, a PLS must ensure the cooperation of its members. But the effectiveness of the mechanisms used to secure this cooperation depends on a PLS’s ability to confer benefits to its members—primarily the ability, not yet existing in a newly-formed PLS, to efficiently enforce norms.

Consider an alternative history replacing \textit{Pax Dei}: the peasants in a region could have convened and agreed to pool their resources, without relying on religion, to intimidate the warlords into undertaking peace oaths. If all peasants followed through with their promise, this norm would benefit them. However, enforcing this norm—like other norms providing public goods—requires addressing a collective action problem: the peasant coalition would deter warlords even if an individual peasant defected, and the resulting peace would benefit all, including those who defected. Further-

\textsuperscript{28} Dick, \textit{supra} note 26, at 268-269.
\textsuperscript{29} Dick does find that cartels that are created to share costs are more sustainable than those created to fix prices, a finding that suggests that the price fixing norm being more adversarial than the cost sharing norm. Dick, \textit{supra} note 26, at 275. For the most part, however, cartel scholarship analyzes adversarial price fixing and market allocating arrangements, rather than other, less adversarial ones.
more, if a single peasant supported the movement while others defected, the movement would fail and the individual peasant would be punished for his participation. A peasant’s incentives, structured here as a prisoner’s dilemma, clearly favored defection.

The PLS literature suggests that reputation facilitates cooperation. But reputation in itself cannot enforce norms. Reputation facilitates norm enforcement only by affecting interactions in a vibrant network that provides important benefits to the party carrying the reputation. When a PLS is in its infancy and does not yet confer significant benefits to its members, one’s reputation among the PLS’s members does not have a significant effect. Stated differently: bad reputation is shorthand for the threat to deploy the three enforcement mechanisms that PLSs use (Part I.A). These mechanisms are only as effective as the network effects from members’ interactions within the PLS. A newly-formed PLS has no network effects and therefore very weak enforcement mechanisms, so having a bad reputation within the PLS is not much of a threat.

The paradox of autonomous formation is a problem of assurance: if all members of a newly-formed PLS could be assured that all other members would comply with a norm, the newly-formed PLS would be as effective as a similarly-sized incumbent. However, bilateral bonding is very expensive (Part I.B) and multi-lateral, centralized bonding (Part I.C) relies on network effects that are not yet realized in the newly-formed PLS. If no other PLS or government enforcer can step in to enforce the norm, and if the norm is sufficiently beneficial to justify the large expense, then perhaps the newly-formed PLS would use costly bilateral bonding to bootstrap the PLS until it developed the network effects that would facilitate effective centralized bonding. But in most cases, an incumbent PLS would expand to enforce the new norm, displacing the newly-formed PLS that suffers from higher enforcement costs.

30. The existence of cartels provides examples of adversarial norms that are enforced without reliance on preexisting non-adversarial core norms. Cartels’ fragility and their near absence in all but the most accommodating environments demonstrates, however, that this is a sub-optimal enforcement method that survives, with moderate effectiveness, only because no superior enforcer displaced it. Another example of private norm enforcement that does not rely on non-adversarial core norms is provided by Karen Clay, who describes trade in Mexican California in the 1830s. Karen Clay, Trade Without Law: Private-Order Institutions in Mexican California, 13 J. L. Econ. & Org. 202 (1997). Unlike the traders described by Landa, supra note 8, and Greif, supra note 9, those described by Clay did not share a common ethnicity or religion. Some collaboration between merchants developed, though it was very limited in comparison to that among the Maghribi traders described by Greif, supra note 9. While the traders in Mexican California exchanged information on dishonest colleagues, they rarely succeeded in imposing collective punishment. In contrast, the Maghribi traders frequently imposed collective punishment—a more adversarial and more effective norm than information sharing.
This occurred in the case of *Pax Dei*. Rather than a new PLS relying on exchanges of collateral between peasants, the peace movement relied on the Christian social network that provided its members with significant spiritual benefits, including a sense of belonging to a community and a sense of security derived from belief in divine oversight. Reneging on what was perceived to be a covenant with God would result in excommunication and the loss of benefits religion provided. While religious faith could aid the success of *Pax Dei*, it was not necessary for the peace movement’s success, as even those members who believed that breaking the peace oaths would not invite divine wrath feared the effects of exclusion from the Christian community.

D. Path Dependent Formation: Core Norms

To avoid the paradox of autonomous formation, PLSs that (ultimately) successfully enforce highly adversarial norms begin by enforcing core norms: non-adversarial norms that members are inclined to comply with even when it is not certain that all members will comply. The most common core norms affect members’ shared identity, and are social, religious, or both. Such norms provide members with a sense of community, social interaction, and spiritual guidance. These norms are not very adversarial; people are more willing to interact socially with a group of strangers than to make binding promises to the same strangers, especially when they are not sure how many of these people would reciprocate.

Norms that shape a shared identity, such as religious, nationalist, tribal, and other norms, tend not to be adversarial because they create a desire in members to enforce the norms, and punish violators, as a vindication of the identity. Allowing someone to violate ideological norms and go unpunished questions the validity of the ideology, or at least the importance of the ideology to the identity of members who acquiesce to the violation. In contrast, by punishing the violator a member reaffirms the centrality of the ideology to her identity. Potential norm violators are less likely to violate norms when the violation questions their identity. No less important, members who do not share the identity, such as a non-believer who is a member of a religious community, would still be hesitant to violate an identity-based norm if they expect that most other members do share the identity and would therefore receive psychic benefit from seeing the norm offender punished.

Another enforcement advantage of core norms that shape a shared identity is that they reduce competition between PLSs by increasing the cost of switching to another PLS. Learning the nuances of a shared identity is time consuming, and the lack of familiarity in them is easy to detect. Thus, they present a relationship-specific investment in a PLS that shares the identity. A member contemplating violating norms enforced by the PLS will
lose the investment he made in learning the network’s culture, and will have to make a new investment in learning the identity of the new PLS he joins. In the meantime, he will be identified by the new network as an outsider, possibly for quite a while. Some identities, such as ethnicity and religions that do not allow members to convert to another religion, make switching PLSs nearly impossible.

Religious norms offer two additional benefits that enhance their ability to regulate believers. First, in religions that include beliefs in an afterlife or reincarnation, both reward and punishment that come after death may incentivize believers. This is a particularly valuable feature in environments of high mortality, or when being taken advantage of may lead to death. Second, since religious norms purport to be enforced by an omniscient and omnipotent god, a believer could view as certain both the detection of violations and the ability to punish.

E. Path Dependent Formation: Expansion Norms

Once a PLS is successfully enforcing a core norm, it can choose to enforce expansion norms that are more adversarial, using the threat of denying violators access to the benefits of the core norm (e.g., with a religious norm, the threat of excommunication). Expansion norms need to satisfy the following conditions:

1. PLS has an incentive to enforce: The enforcement norm must be attractive to enforce through the PLS from the perspective of the members that direct the PLS’s behavior—the PLS controller. In other words, the PLS controller must gain a net benefit from allowing the PLS to enforce the

31. As Ellickson reports, people who resided in Shasta County for a decade were still viewed by most locals as newcomers and outsiders. Ellickson, supra note 1, at p. 38, footnote 14.
34. Consider the Pax Dei prohibition on warfare during holy days: if person A abides by the norm, say by refraining from attacking on a holy day, while person B violates the norm and surprises A, then A may die. If punishment and rewards are limited to one’s lifetime, then the risk of being taken advantage of may make this norm unenforceable, since A cannot be rewarded posthumously for complying with the norm. However, a reward in one’s afterlife may be sufficient incentive for a believer to abide by the norm.
35. Consider a norm of honoring one’s promises, enforced at a time of very high mortality, such as during a plague. If A is to honor her promise, she foregoes the option of opportunistically reneging on a now unprofitable promise. In return, she may expect others to honor their promises in the future. But if A believes she may die soon, before others honor their promises to her, she may renege now. Yet if A believes that she would be rewarded in her afterlife, or be reincarnated in a manner that rewards her for her good deeds in her current life, then her death does not constrain the ability to incentivize her.
norm, and that benefit must be greater than the benefit to the PLS controller from having the norm enforced by another institution, such as another PLS, a government regulator, or bilateral contracts.

(2) PLS is able to secure member compliance: The expansion norm’s enforcement costs must be lower than members’ benefits, prior to expansion, from membership in the PLS. Otherwise, expulsion from the PLS would not deter potential norm violators. At an early stage of a PLS’s evolution, while it enforces relatively few norms, it can expand only to slightly more adversarial norms. However, with each successful enforcement of an expansion norm, the benefit from membership increases because the PLS is enforcing an additional norm that is presumably advantageous to members. This allows the PLS to then select expansion norms that were too adversarial to enforce earlier.

(3) Member compliance is sufficient: Securing the compliance of the PLS’s current (pre-expansion) members must be sufficient for the expansion norm to yield a net benefit to the members without requiring compliance of other parties. A PLS’s enforcement mechanisms are effective against only its members. If a potential expansion norm requires the cooperation of a different set of actors, then the PLS would not have a particular advantage in enforcing that norm.

The PLS literature on the enforcement of adversarial expansion norms is much richer than on core norms. Adversarial expansion norms attract the attention of legal scholars and economists because they are more similar to the norms enforced by the public legal system—they look more like “law.” The literature’s focus on the content and efficiency of the norm rather than on a norm’s enforcement costs places the spotlight on the more complex—and adversarial—expansion norms. While these expansion norms attract much attention, the core norms that support them are often ignored or treated as curious details rather than essential elements.

Notable exceptions are Landa, who highlighted the role of ethnic ties in facilitating long-distance trading of rubber in Singapore and West Malaysia, and Greif, who highlighted the role of ethnic and religious ties in long-distance trading in the Mediterranean during medieval times. Both articles emphasize the importance of the ethnic/religious core norm in supporting an adversarial expansion norm (in these cases, honoring one’s contracts). Lisa.

37. For an analysis of case studies from the PLS literature reinterpreted through the lens of core norms supporting expansion norms, see Aviram, Paradox, supra note 10, at pp. 46-58.
38. Landa, supra note 8.
Bernstein\textsuperscript{40} and Barak Richman\textsuperscript{41} likewise highlight the role of religion in enforcing informal contrasts among diamond dealers.\textsuperscript{42}

These articles, however, confine themselves to a particular adversarial norm: the enforcement of informal contracts. They also focus almost exclusively on the particular core norm that appears in the case study each article considers—an ethnic norm in the case of Landa,\textsuperscript{43} and an overlapping ethnic and religious norm in the cases of Greif, Bernstein and Richman.\textsuperscript{44} This Article presents a broader theory that attempts to unify common traits of these seemingly disparate norms, distinguishing norms by the degree they are adversarial and demonstrating how that difference determines which norm gets enforced first and by whom.

Furthermore, most PLS scholarship treats PLSs as static, endeavoring to explain why an existing PLS is effective but not how it came to be effective. In contrast, this Article considers the dynamic process of PLS development and suggested how it is that a PLS comes to bundle the enforcement of particular norms, and in what order.

**III. ON IDENTITY AND NORM ENFORCEMENT**

This Article argues that the development of PLSs is path dependent, because in most environments highly adversarial norms will be enforced by incumbent PLSs that began by enforcing non-adversarial core norms—mainly norms that create a shared identity among members. Since the content of a norm depends on the preferences of the enforcing PLS, the content of new, highly adversarial norms will depend on which PLSs already exist and enforce less adversarial norms on the same group of members whose behavior needs to be regulated to ensure the success of the new norm.

The economics of identity have received increased attention from scholars in recent years. In the context of the group norms, some scholars called to replace traditional, incentive-based models (in which an actor follows norms because of fear of punishment for others if she deviates) with identity-based models (in which an actor follows norms because it fits with


\textsuperscript{42} Ellickson, supra note 1, also connected a core norm to an expansion norm by highlighting the importance of social identity (neighborliness) in the PLS that addresses cattle trespassing on farmland. Ellickson’s focus, however, was on the content of the expansion norm—how were trespasses addressed and how does it compare to the legal rule—rather than on the PLS’s enforcement costs.

\textsuperscript{43} Landa, supra note 8 (examining ethnic Chinese traders in Malaysia).

\textsuperscript{44} Greif, supra note 9; Bernstein, supra note 38; Richman, supra note 41 (all three articles examine Jewish traders).
While identity no doubt plays a role in human behavior, identity-based models may underemphasize the role that incentives, including fear of punishment by others, play in human behavior, particularly when stakes are high. They also underemphasize cognitive biases that allow individuals to subconsciously interpret their environment and actions in a self-serving way, thus allowing an actor to act in a self-serving way while sincerely believing that he is acting in accordance with an altruistic identity.

In this Article I suggest an alternative way to incorporate identity into models of group norms and norm enforcement without abandoning incentives. The ultimate motivator for compliance with norms is an actor’s incentives, particularly fear of punishment by others. But in all but the most benign environments, highly adversarial norms cannot be sustainably enforced without the support of an incumbent institution that enforces a preexisting core norm—one that facilitates a shared identity.

In conclusion to this Article, I would like to discuss a potential bypass to the path dependent formation of PLSs, and at the same time introduce into the PLS literature a body of historical scholarship that has thus far not been considered: work on the “invention of tradition.”

The “invention of tradition,” a term coined by Eric Hobsbaum & Terence Ranger, is a (surprisingly common) phenomenon of artificially creating a shared identity through “‘a set of practices . . . of a ritual or symbolic nature, which seek to inculcate certain values and norms of behavior by repetition . . . [and] attempt to establish continuity with a suitable historical past.”

Invented tradition can be false, and some traditions have been alleged to be false. One example is the Scottish Highlander “traditional” garb, which Hugh Trevor-Roper claimed had developed after the Union with

47. Eric Hobsbaum, Introduction: Inventing Traditions, in Hobsbaum & Ranger, id., at p. 1. While many invented traditions are orchestrated by governments, they can and are occasionally orchestrated by private parties. Private parties invent tradition in a variety of ways, including barter friendships, which oblige the parties to similar standards of loyalty to those they owe their kinsmen (see Richard Posner, A Theory of Primitive Society, with Special Reference to Law, 23 J. L. & ECON. 1 (1980)), and political adoption, in which two individuals (frequently, both adults) accept the status of parent and child, respectively, motivated by political reasons such as unifying or strengthening a dynasty (see Hugh Lindsay, ADOPTION IN THE ROMAN WORLD (Cambridge University Press, 2009) 169-173). Dynastically-motivated adult adoption is practiced today in Japan. See Vikas Mehrotra, Randall Morck, Jungwook Shim, & Yupana Wiwattanakantang, Adoptive Expectations: Rising Sons in Japanese Family Firms, 108 J. Fin. Econ. 840 (2013); Keeping It in the Family, The Economist (Dec. 1, 2012), p. 46.
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England. Another example is the biblical stories of a unified Israelite-Judean kingdom ruled by the House of David from Jerusalem, which, Israel Finkelstein and Neil Silberman speculate, is a fiction created by Hezekiah, an eighth century BC Judean king, in an attempt to unify a mixed population of native Judeans and refugee Israelites in preparation for rebellion against the Assyrian Empire.

Other invented traditions may be historically true, but are emphasized and ritualized in a context that channels historical identity into a contemporary target. An example, described by Yael Zerubavel, is the veneration of Joseph Trumpeldor in Israel during the decades just prior and just following Israeli independence. Trumpeldor, a former officer in the Czarist army, was in 1920 among the residents of the Jewish village of Tel Hai, then on the border between French and British zones of control in territory captured from the Ottoman Empire in the First World War. Tel Hai was attacked by an Arab militia and Trumpeldor died in the attack. Almost immediately Trumpeldor became a role model—a fighter and a farmer who died heroically in the defense of Tel Hai. He was portrayed as a continuation of a line of Jewish heroes going back to biblical times. With the possible exception of Trumpeldor’s dying words—“it is good to die for our country”—the facts surrounding Trumpeldor’s life and death are seen as historically accurate.

Yet as Zerubavel points out, his elevation to a status of hero, the emphasis on his dedication to the greater good and on his military prowess, and the association between him and ancient Jewish military leaders all seem calculated to develop a shared image of the Jewish population in British Palestine as heroic, community-minded, tied to the land, and able to defend itself. This image was designed to suggest continuity with the image of the Jewish community of ancient times, while contrasting with an image of Jewish Diaspora communities as helpless, nomadic, and lacking military and agricultural proficiency. This image helped mobilize the community as it engaged in an increasingly bloody struggle leading to, and then following, the creation of the state of Israel.

If tradition can easily be invented, then path-dependent formation of PLSs is not necessary. A collaborative core norm can be instantaneously invented when a more adversarial norm needs to be enforced, rather than relying on an incumbent PLS. For example, if Finkelstein & Silberman’s speculation on the unified kingdom is correct, then native Judeans and refu-

49. Israel Finkelstein & Neil Asher Silberman, DAVID AND SOLOMON (Free Press 2006) 121-149.
gee Israelites may not have seen each other as kin before Hezekiah’s invented tradition of a unified kingdom, but upon accepting that tradition Hezekiah could instantaneously enforce more adversarial norms, such as paying taxes to support a fortification effort, or willingness to serve in the military in the defense of both ethnic groups.

However, the impact of invented traditions on PLS enforcement may not be so dramatic. Even an anecdotal observation of PLSs (as done, for example, in the introduction to this Article) demonstrates that the enforcement of highly adversarial norms does tend to rely on incumbent PLSs that enforced less adversarial core norms. If inventing tradition were easy and effective, one would expect an autonomous formation world in which numerous PLSs enforce highly adversarial norms without a history of enforcing core norms, but rather supported by instantaneously invented traditions. Instead, invented traditions that are not supported by incumbent PLSs seem to appear in the public legal and political systems, where enforcement utilizes government’s monopoly on legitimate violence and thus does not need to rely on tradition to the same degree as PLSs. Invented tradition, if it matters at all in those contexts, increases government legitimacy on the margin, but public enforcement still relies on the police or military rather than on voluntary compliance due to a shared identity formed by a newly-invented tradition.

Zerubavel may have identified a key limitation on the invention of tradition in her observation that belief in invented tradition tends to rely more on credibility (assessed according to the fit between the tradition and the individual’s existing identity) than on historical validity. She considers a controversy as to Trumpeldor’s dying words, which the original tradition claimed were, in Hebrew, “it is good to die for our country,” but which a later tradition claimed were a crude Russian curse. The former interpretation fit a community in the midst of a military struggle, which needed military heroes and a willingness of individuals to sacrifice for the good of the community. The latter interpretation fit a community that gave more emphasis to individual needs and aspirations and was wary of heroes and demands for sacrifice. Zerubavel points out that while historical evidence is, on balance, more supportive of the original tradition of Trumpeldor’s dying words, the later tradition had become more accepted. Historical truth was secondary to coherence with one’s values and identity.

Here, again, identity plays a role in norm enforcement. If invented tradition succeeds when it conforms to preexisting values and identity, then it is endogenous to the development of PLS, because an invented tradition will enhance an existing core norm of a shared identity, but will fail when it conflicts with the existing core norm. Incumbent PLSs that are enforcing

51. Zerubavel, id., at 117.
core norms can be expected to enhance their enforcement power not only by adding expansion norms, but also by maintaining and buttressing the core norm through invented tradition. This interpretation explains why, despite the prevalence of invented tradition, successful PLSs enforcing highly adversarial norms rely on long-established core norms rather than on invented tradition.

Further inquiry into the role of invented tradition, and particularly the limits on effective invention of tradition, is beyond the scope of the present Article. Looking ahead, this line of scholarship has great promise in enriching the literature on private ordering and particularly in allowing scholars of PLSs to better incorporate the dynamic role of shared identity on norm enforcement.