The Impetus for Recognizing Private Property and Adopting Ethical Behavior in a Market Economy: Natural Law, Government Law, or Evolving Self-Interest

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I. Introduction

Mises (1949, p. 725) convincingly argues that, *given* the existence of the long-run objectives instilled by private property rights, cooperation in the form of division of labor and trade emerge naturally; and therefore, under these circumstances, "there is no need to enforce cooperation by special orders or prohibitions." His explanation is clear: when private property rights are defined and enforced, the

> reason why the market economy can operate without government orders telling everybody precisely what he should do and how he should do it is that it does not ask anybody to deviate from those lines of conduct which best serve his own interests. What integrates the individual's actions into the whole of the social system of production

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> is the pursuit of his own purposes. In indulging in his "acquisitiveness" each actor contributes his share to the best possible arrangement of production activities. (Mises 1949, pp. 725–26)

But where do the property rights come from? Some suggest that there is a "natural law," perhaps given by some superhuman power (or by the conscience of wise and decent men) which also has entrusted authority into the hands of enforcement institutions. Another answer, legal positivism in the tradition of Hobbes and Austin, typically identifies law with observed legal institutions: generally the state. This view assumes that without a monopoly in police and/or military power by a coercive centralized authority, anarchy characterized by continual conflict will exist, and that whatever the state defines as law is "law." Thus, the state is the necessary prerequisite to the establishment of the fundamental ethical behavior that supports a free market: Presumably individuals will not respect private property, fulfill obligations, or recognize contracts unless a coercive authority forces them to do so. In fact, legal positivism is closely related to the natural law. As Mises (1985a, p. 11) suggests, "A new type of superstition has got hold of people's minds, the worship of the state."

Mises correctly rejects the natural law doctrine. For example, he (1949, p. 720; also see p. 146; 1985b, pp. 44–49, 82) explains that rules and laws are made by people for specific purposes: there is "no such thing as a perennial standard of what is just and what is unjust. . . . All moral rules and human laws are means for the realization of definite ends. There is no method available for the appreciation of their goodness or badness other than to scrutinize their usefulness for the attainment of the ends chosen and aimed at." In a market economy, the ends are the gains from trade that arise given recognition of private property, and the resulting long-run increases in wealth for those involved. And as Mises says:

> there is nothing inhuman or mystical with regard to the market. The market process is entirely a result of human actions. Every market phenomenon can be traced back to definite choices of the members of the market society. The market process is the adjustment of the market society to the requirements of mutual cooperation. (1949, p. 258)

Mises also rejects parts of the legal positivist view. In fact, he (1985b, pp. 47–48) suggests that "[t]he chief accomplishment of the natural law idea was its rejection of the doctrine (sometimes called legal positivism) according to which the ultimate source of statute law is to be seen in the superior military power of the legislator who

is in a position to beat into submission all those defying his ordinance. . . . it is an illusion to deny that the best system of laws cannot be put into place unless supported and enforced by military supremacy." There clearly are, in Mises's mind, appropriate and inappropriate laws (e.g., see 1985a, pp. 46–50). For instance, he emphasizes (1985a, p. 58) that "[g]overnments have always looked askance at private property. . . . It is the nature of the man handling the apparatus of compulsion and coercion . . . to strive at subduing all spheres of human life to its immediate influence." And he maintains that one function of the "law" is to constrain the discretionary application of coercive powers by officeholders and bureaucrats (1983, p. 76). Yet, Mises does not take the final step and reject all of tenets of legal positivism. He accepts the view that a state's authority is essential for controlling individual's tendencies toward unethical behavior:

> The state is essentially an apparatus of compulsion and coercion. The characteristic feature of its activities is to compel people to behave otherwise than they would like to behave. . . . With human nature as it is, the state is a necessary and indispensable institution. The state is, if properly administered, the foundation of society, of human cooperation and civilization. (Mises 1985a, pp. 46–47)[1]

Without the state, Mises (1985a, p. 48) expects that anarchy à la Hobbes will prevail. In fact, despite recognizing that the state is always a threat to property rights, Mises (1949, p. 725) maintains that it is also the source of those rights, or at least of their protection: "Beyond the sphere of private property and the market lies the sphere of compulsion and coercion; here are the dams which organized society has built for the protection of private property and the market against violence, malice, and fraud. . . . here are rules discriminating between what is legal and what is illegal, what is permitted and what is prohibited."

The Hobbesian jungle is not the only alternative to the state, however. Indeed, there is another possible source of property rights and behavioral rules, which a direct extension of Mises's analysis of self-interest incentives for cooperation under private property can explain. Thus, the purpose of the following presentation is to extend, to a more fundamental level, the theoretical explanation offered by Mises as to "why the market economy can operate without government orders telling everybody precisely what he should do and how he should do it," by demonstrating that the same reasoning also

[1]Also see Mises (1983, p. 18; 1985a, pp. 48–50), and footnote 13.

applies to incentives for cooperation in establishing, recognizing, and enforcing private property rights.[2] Given long-run goals rather than short-run concerns, individuals have incentives to enter into cooperative arrangements in order to reduce their costs of defending possession claims and to enhance the property's value by increasing the potential for mutually beneficial interaction, including division of labor and market exchanges. As Rothbard (1970, p. 3) contends, "no State or similar agency contrary to the market is needed to define or allocate property rights. This can and will be done by the use of reason and through market processes themselves; any other allocation or definition would be completely arbitrary and contrary to the principles of the free society." Section II of the following presentation explains why and how self-interested individuals within a particular group will voluntarily adopt the behavioral rules and develop the basic institutional framework that underlies and facilitates a free market, as well as other mutually beneficial interactions. The fact is that even though the concept of a perennial "natural law" is erroneous, "customary law" can evolve naturally or spontaneously, just as Adam Smith described the evolution of markets: "as if guided by an invisible hand." Section III examines the various competitive and cooperative relationships that can arise between groups which facilitate the spread of customary law. It is not contended that the voluntary evolution of the ethical behavioral rules and institutions of customary law *must* arise, however. Rather, the point is that they *can* and *do* arise without a coercive centralized authority. Thus, the concluding section considers the issue of why a centralized coercive authority appears to be the source of law in most modern societies. The fact is that the voluntary rules and

[2]Recognize with Mises (1985a, p. 14), that in order to "understand the present state of political affairs [we] must study history," and note that the literature on legal history reveals a substantial amount of evidence which makes "clear that property and contract were . . . functioning social institutions before state-made laws existed or were even conceived of" (Fuller 1981, p. 174). Many predominantly voluntary arrangements for internal order have been described by anthropologists, historians, and scholars studying modern groups and associations (e.g., see [Hoebel 1954, 1967; Barton 1967; Popisil 1971; Goldsmidt 1951; Peden 1971; Friedman 1979; Berman 1983; Trakman 1983; Umbeck 1981; Berman and Dasser 1990]). Nonetheless, while some economists (e.g., Rothbard [1970]; Friedman [1973]) recognize the logical contradiction between a voluntary, decentralized free market and a centralized, coercive authority for law, an observation made by Leoni (1961, p. 90) still generally applies: The fact is that even Mises and others "who have brilliantly defended the free market against the interference of the authorities have usually neglected the parallel consideration that no free market is really compatible with a law-making process centralized by authorities." Thus, a theoretical presentation using the game-theoretic jargon of "modern" economics seems appropriate.

institutions are not universally observable because conflicting incentives also exist which are more effectively served by authoritarian institutions and laws. Indeed, the evolution of law in most societies is actually shaped by the ebbs and flows of the natural conflict between customary and authoritarian institutions and norms within and between groups, a conflict that Mises clearly recognizes (1985a, pp. 58, 104, 240). The examination of this conflict emphasizes that the expanding scope of centralized authority does not reflect its superiority in preserving and protecting private property or in facilitating voluntary interactions such as those which characterize a market economy.

II.
The Evolution of Ethics and Law Within a Cohesive Group

As Mises explains, cooperation in a market process generates long-run benefits for everyone (1985b, p. 236), but if some individuals focus on short-run considerations, long-run benefits may not be achieved. The question is, under what circumstances are incentives tied to short-run considerations? In the jargon of game theorists: if every potential market exchange between people involves a discrete, simultaneous one-shot game, then mutually beneficial interaction is unlikely in the absence of some threatened sanction by a coercive power. Short-run concerns dominate potential long-run benefits. While this argument applies to cooperative exchange, it also applies to cooperation in the form of collective recognition and compliance with a set of ethical values. An individual, person *A*, who bears personal costs from adopting some type of conduct that constrains him in some way (e.g., respecting someone's private property rights and therefore not using that property without permission, perhaps involving a payment for the use) will get nothing in return if the other individual, *B*, does not adopt a similar set of values and cooperative behavior (e.g., if *B* does not recognize *A*'s property rights). Uncertainty about the behavior of *B* in the resulting one-shot prisoner's dilemma-type situation induces non-cooperative behavior by *A*, and vice-versa. This prisoner's dilemma scenario does not characterize many kinds of social interactions, however (Tullock 1985). Individual's choices regarding interaction with others are part of a continuous process, with each unique decision representing only one link in a long-time chain of interaction. For example, most businessmen expect to be active for a long time and to be involved in interactions with other businessmen and consumers over and over. Their focus is long run, not short run.

A more appropriate characterization of many interactions might be as multi-contact or repeated games. Indeed, in a repeated game

setting with a finite uncertain horizon, cooperation becomes possible (à la Luce and Raiffa [1957] and Axelrod [1984]), although it clearly is not certain.[3] This includes the potential for ethical behavior. For instance, Fuller (1964, pp. 23–24) suggests three conditions which make mutually recognized duties or obligations clear and acceptable to those affected. First, the relationship of reciprocity from which the behavioral obligations arise "must result from a voluntary agreement between the parties immediately affected; they themselves 'create' the duty." Second, the reciprocal acceptance of the duties must be equitable in the sense that both parties must expect to gain: the exchange cannot be one-sided so that one person gains and another loses, once again emphasizing the paramount role of self-interest motives. Third, the parties must expect to interact on a fairly regular basis because the relationship "must in theory and in practice be reversible." That is, given reciprocal gains in a repeated game situation, recognition of common behavioral norms becomes likely as each individual recognizes that the long-term benefits of remaining on good terms with the other party by doing so are likely to be greater than the immediate benefits of not cooperating (e.g., taking another person's possessions, committing fraud).

Even a repeated game involves weaker incentives to recognize a common set of behavioral norms than those which exist in many situations (Tullock 1985). In particular, each individual chooses to enter into several different games with different players. Thus, refusal to behave ethically within one game can affect the person's reputation and limit his ability to enter into other games to the extent that reputation travels from one game to another. When players value ongoing relationships with other reliable players more than the potential benefits associated with refusing to follow accepted behavior in any single game, then the potential for cooperation in the form of recognition of standard behavioral norms is even greater than in simple repeated games (Schmidtz 1991, p. 102). Tullock (1985, p. 1073) refers to this combination of multiple games over time with reputation effects using Adam Smith's phrase: "the discipline of repeated dealings." The incentives to cooperate that arise from repeated games are effectively reinforced, because anyone who chooses a non-cooperative strategy in one game will have difficulty finding a partner for any future game (Tullock 1985, pp. 1075–76). Therefore, in order to maintain a reputation for fair dealings or "high moral standards," each player's dominant strategy is to behave ethically

[3]Actually, the solution still depends on payoffs and other considerations (Tullock 1985, p. 1073).

throughout each game, whether repeated or one shot. And as a consequence, in Mises's words:

> social cooperation becomes for almost every man the great means for attainment of all ends. An eminently human common interest, the preservation and intensification of social bonds, is substituted for pitiless biological competition . . . Man becomes a social being. . . . Other people become his fellows. . . . For man, until the optimum size of population is reached, it means rather an improvement than a deterioration in his quest for material well-being. (1985b, p. 56)

Property rights under "customary law"

Recognition of private property rights and the rights of individuals (rules against violence, malice and fraud) are likely to constitute the most important of the voluntary and mutually recognized duties or obligations when interactions arise out of reciprocity and reputation (Benson 1989b; 1990).[4] After all, individuals must expect to gain as much or more than the costs they bear from voluntarily constraining their behavior in light of common behavioral norms. Indeed, voluntary adoption of commonly accepted behavior (and participation in the institutions that develop to support those values, as noted below) is likely to arise only when substantial benefits from doing so can be internalized by each individual. Recognition by others of a person's possessions as that person's private property is a very attractive benefit.[5] Therefore, individuals have incentives to reciprocate and recognize other individuals' property rights in order to reduce their own costs of defending possession claims, and to enhance the property's value by increasing the potential for mutually beneficial interaction, including market exchanges. From an individual's perspective, such behavioral norms involve both rights and obligations

[4]It should be emphasized that there is no distinction between criminal and tort law in a customary legal system. However, a large proportion of the offenses which appear in a modern criminal code are still illegal (e.g., see Hoebel [1954, 1967]; Barton [1967]; Benson [1989a, 1990, 1991b, 1992b]; Popisil [1971]; Goldsmidt [1951]; Peden [1971]; Friedman [1979]). Indeed, the primary concern of such a voluntary system is protection of private property, including prevention of theft and violence.

[5]Indeed, private property is a key characteristic of all societies wherein reciprocity and reputation is the primary impetus for recognition of behavioral norms or values (Benson 1990). In such a setting, there does not even appear to be any viable reason for voluntary cooperation that does not involve a relative increase in the degree of privatization of rights to property for the group. Individuals with no existing claims to property might conceivably cooperate in order to take property out of the commons and restrict others' access to it, for example; but the result, if the group is successful, is that access and use rights to the property and claims to the benefits from such use become internalized by the group (i.e., privatized relative to what they were).

(recognition of other individual's rights), of course. Indeed, "all such relationships entail domination and submission" (Leach, 1977, p. 19). In some cases an individual's rights dominate, but in other cases the individual must submit to the interests of someone else: " 'the law', by which I here mean the customary rules of society, . . . says who must submit to whom and in what context" (Leach 1977, p. 19). The use of "customary rules" is appropriate here. Recognition of property rights becomes a customary obligation. Indeed, even today, as Hayek (1973, pp. 96–97) explains, many issues of law are not "whether the parties have abused anybody's will, but whether their actions have conformed to expectations which other parties had reasonably formed because they corresponded to the practices on which the everyday conduct of the members of the group was based. The significance of customs here is that they give rise to expectations that guide people's actions, and what will be regarded as binding will therefore be those practices that everybody counts on being observed and which thereby condition the success of most activities."

Property rights are more a matter of economic value than of legal definition. That is why Mises's (1949, pp. 725–26) arguments about the reasons for cooperation in a market readily extend to explain cooperation in rights formation. The fact that the potential for long-run gains implies that self-interest incentives to cooperate in market activities arise given recognition of private property rights also implies that incentives can exist to cooperate in the establishment of such rights, given that individuals have long-run objectives.

Similar incentives motivate the development of legal institutions; and when a system of behavioral obligations is backed by institutions for resolution of disputes and enforcement of obligations, the result is a legal system (Fuller 1964; Benson 1990). If a legal system develops from the bottom up through voluntary arrangements, as suggested here, it can be referred to as "customary" law (Fuller 1964). A customary legal system is based on individual decisions reflecting individual self-interest, because each individual finds it beneficial to obey certain rules (even though each probably recognizes that these rules may occasionally work to his disadvantage) and to contribute to the costs of enforcement, in anticipation that the long term benefits will exceed the costs.

Institutions for Adjudication and Enforcement of Customary Behavioral Rules

When a group of frequently interacting people is sufficiently small and stable so that reputations are well-known and trust relationships are strong, there is little need for a formal institutional

arrangement, perhaps beyond the institution of the immediate family. The self-interest impetus for new institution formation can arise when the potential for beneficial interaction expands to a larger and/or less stable group than one in which everyone knows everyone else's reputations well enough to establish individual trust relationships. As the group expands or becomes more dynamic (e.g., perhaps because of increasing potential for specialization and division of labor), individuals will want to interact with increasing frequency and/or with growing numbers of other individuals with whom reciprocities and reputation effects may not be firmly established. Such interaction, while desirable, also increases the potential for dealings with someone who in fact does not behave as expected, which in turn creates the potential for a disagreement as a result of theft, deliberate fraud, malicious slander, or some other form of taking of property rights. Therefore, for such expansion to occur, each party's commitments to accept commonly expected norms of behavior must be credible.

One way to unilaterally try to insure credible commitments by another party to fairly resolve disputes is "self-help" (Nader and Todd 1978, p. 10): that is, accumulation of human or mechanical assets for inflicting violence in order to threaten retaliation if the other party does not behave as expected. This should reduce the probability of an intentional offense against the individual, and increase the probability that the individual can make a property rights claim stand. However, this can also be quite costly. Furthermore, when the threat of violence is not sufficient and a dispute arises, the relevant institution for dispute resolution is the "feud" or vengeance (Leach 1977, p. 24).

Unilaterally, an individual in a dispute has only two options besides violence. He can simply decide that the cost of pursuing the claim is too high, and drop it, while continuing to interact with the perceived offender, or he can choose not to pursue the claim, *and* to discontinue interactions with the other individual. The relative costs and benefits of these options will be weighed if an individual unilaterally makes a choice; and if the property rights are expected to be more valuable than continuing the relationship, violence will be chosen (Nader and Todd 1978, pp. 10 and 18). Both individuals face similar alternatives, however; so in combination, they actually have a fourth option. They can negotiate a peaceful solution (Nader and Todd 1978, p. 10). In doing so, they attempt to delineate previously undefined property rights or reestablish the rights that have been intentionally taken. Personal strength still plays a role in negotiation, of course, in that it can establish a bargaining advantage. Furthermore, direct negotiation may not be successful, so violence or loses due to acquiescence are still threatened.

The high cost of either unilateral actions in maintaining personal strength or of bearing losses due to acquiescing is an important source of the incentives that individuals with mutual interests in long-term interaction have to form groups or associations for mutual support, even when feuding is still intended to be the ultimate means of dispute resolution. Transactions costs fall through organization and institutions for mutual support. That is, the benefits of negotiation (violence avoidance and maintenance of long-term relationships) are increased. Backing by a combined threat from the group reduces the probability of an intentional offense, reduces the costs for member individuals of large personal investments in the tools of violence, reduces the probability that an individual will have to defend his property relative to what it would be in the absence of such an organization, reduces the likelihood that violence will have to be employed to resolve a dispute, and increases the probability that negotiation will be successful. Furthermore, when negotiation fails, the costs of violent dispute resolution are now shared by the group (e.g., as in a "blood feud"). As feuding begins to create costs for others in the group, incentives arise to offer lower cost means of non-violent dispute resolution than direct negotiation. Indeed, mutual support groups are particularly attractive if group members are obligated to (1) act as or provide access to third parties that mediate or arbitrate any dispute between members, (2) assess judgments to make sure that they are just and consistent with existing property rights, and if necessary, (3) help enforce the dispute's resolution (Benson 1990).[6]

If a dispute between group members arises, for instance, pressure might be brought to bear by the group as a whole (the nature of such pressure is examined below) to induce mediation, leading to a settlement viewed to be "fair" by the group at large. A mediator acts as a disinterested go-between who assists the disputants in their negotiations. This may allow the parties to remain apart, thereby avoiding potentially dangerous direct confrontations. Another low

[6]Note that the mutual support group may have many functions besides its legal role. Primitive kinship groups, for example, might have been primarily concerned with cooperative production of food, shelter, protection from outside threats (or taking of wealth from outsiders, as noted below), and/or religious functions. Even though they also developed a system of customary law to maintain internal order, they may not have fully recognized the importance of this function for facilitating interaction, attributing the results instead to some mystical source. As Mises (1985b, p. 240) notes, "Where people did not know how to seek the relation of cause and effect, they looked for a teleological interpretation. They invented deities and devils to whose purposeful action certain phenomena were ascribed. A god emitted lightning and thunder. Another god, angry about some acts of man, killed the offenders. . ." Also see footnote 8 and related discussion.

transactions cost alternative may be a mutually acceptable arbitrator, with an agreement by the disputants to accept the arbitrator's decision. As Leach (1977, p. 24) notes, however, "even then, the function of the arbitrator is simply to restore peace; it is not part of his duty to adjudicate about the rights and wrongs of the conflict or to inflict penalties." Given this function, it is not surprising that in primitive or religious societies an arbitrator can be supernatural (Nader and Todd 1978, p. 11): "When both parties agree to perform an ordeal or divination and accept the outcome as a decision, the third party in the arbitration is a nonhuman agent."

Rather than assisting in negotiations, the arbitrator considers the issue and proposes a solution which, *ex ante*, the parties have agreed to abide by (a superhuman arbitrator reveals a decision by the failure of one of the parties to survive the ordeal unharmed). The parties involved must expect the benefits from resolving the dispute peacefully (clarifying rights or, in the case of an intentional offense, reestablishing the old right) to outweigh the cost of resolving the dispute in that manner, or they would not take it to the arbitration (or mediation) system: for instance, if arbitration is perceived to involve more costs than other methods of dispute resolution (e.g., violence, direct negotiation), perhaps because the arbitrator is expected to be arbitrary or biased, then arbitration will not be pursued. Indeed, if one party in the dispute perceives a high cost arising from a peaceful settlement (e.g., because he knows he is guilty), he can still resort to violence. Therefore, the "borderline between law and war" is not fixed (Leach 1977, p. 25), and depending on the individual's perception of relative costs and benefits, any of the resolution mechanisms discussed here (violence, acquiescing, negotiation, mediation, and arbitration) can be observed. Of course, when members of a group are affected by a violent dispute they have strong incentives to raise the cost of violence for group members, *and* to lower the cost of non-violent dispute resolution.

In order to raise the cost of violence, acceptance of non-violent dispute resolution will become a customary obligation that is required for group membership. Customary rights and obligations that induce non-violent dispute resolution can include such things as family loyalty, obligations for past care, honor (or reputation) and the shame that comes with disrupting the social order or invoking the wrath of some supernatural arbitrator. Indeed, resort to violence without first trying to achieve a non-violent solution will result in ostracism by the group. That is, refusal to behave according the accepted rules of conduct, including acceptance of non-violent dispute resolution, can be "punished" by boycott (i.e., exclusion from some or

all future interaction with other members of the group). This is possible because customary law is tightly bound with all other aspects of life. Fear of this boycott sanction reinforces the self-interest motives associated with maintenance of reputation and reciprocal arrangements. It also deters intentional offenses. In other words, because each individual has made an investment in establishing himself as part of the community (e.g., establishing a reputation), that investment can be "held hostage" by the community, à la Williamson (1983), in order to insure that the commitment to cooperate is credible.

Furthermore, the costs of non-violent dispute resolution will naturally fall as the institution evolves. After all, since the arbitrator/mediator must be acceptable to both parties in the dispute, "fairness" becomes embodied in the dispute resolution process. As Buchanan emphasizes (1975, p. 68), "Players would not consciously accept the appointment of a referee who was known to be unfair in his enforcement of the rules of the game or at least they would not agree to the same referee in such cases. 'Fairness' or 'justice' may emerge, therefore, in a limited sense from the self-interest of persons who enter into an enforcement contract."

The arbitrator or mediator will have no vested authority to impose a solution on disputants (Leach 1977, p. 24). They are not "adjudicators" backed by coercive power. Under such circumstances, the ruling must be acceptable to the group to which both parties in the dispute belong. An arbitrator or mediator's only real power in such a system is that of persuasion.[7] Indeed, as Fuller (1981, pp. 110–11) explains, "Being unbacked by state power . . . the arbitrator must concern himself directly with the acceptability of his award. He may be at greater pains than a judge to get his facts straight, to state accurately the arguments of the parties, and generally to display in his award a full understanding of the case." This is particularly likely if either: (1) the arbitrator is a specialist who wishes to build a reputation for good decisions in order to maintain or enhance his position in the market for arbitration services, or (2) the arbitrator is a highly reputable member of the community that wishes to maintain that reputation for other reasons. Thus, if the group is large enough so that disputes are not uncommon, certain highly reputable

[7]In this light, Fuller (1981, p. 134) observes that "A serious study of mediation can . . . offset . . . [the assumption] that all social order must be imposed by some kind of 'authority'. When we perceive how a mediator, claiming no 'authority', can help the parties give order and coherence to their relationship we may in the process come to realize. . . . that social order can often arise directly out of the interactions it seems to govern and direct."

members of the community may be called on to arbitrate disputes so frequently that they can have some formal designation (e.g., elderman, peace chief, consul; see Benson [1989a, 1990, 1992b] and Popisil [1971]). Alternatively, an approved pool of competitive arbitration or mediation specialists might develop (see Hoebel [1954]; Barton [1967]; Benson [1989a, 1990, 1992a]; Berman and Dasser [1990]; and Peden [1971]).

Given that the arbitrator has convinced the individuals in the affected group that a proposed judgment should be accepted, the loser must pay the arbitrated restitution in order to maintain his position within the group; i.e., he buys back his reputation. Because "fairness" is essential for arbitration to arise in a voluntary system, the ruling can also be backed by a threat of ostracism by the members of the entire group (e.g., see Hoebel [1954, 1967]; Barton [1967]; Benson [1989a, 1989b, 1990, 1991a, 1991b, 1992a, 1992b]; Berman and Dasser [1990]; Popisil [1971]; Goldsmidt [1951]; and Trakman [1983]). Thus, decisions can be enforced without backing by a centralized coercive authority.

The nature of the sanction is also likely to vary depending upon the intentions and status of the offender. After all, the members of a group wish to deter costly and potentially violent disputes. Disputes that arise because conditions change in unanticipated ways cannot be effectively deterred, of course; but intentional violation of customary behavioral rules by theft, fraud, or malicious slander can be deterred by explicitly setting a higher payment to buy back the peace. In other words, when an intentional offense occurs, the payment is likely to include both restitution and retribution. Indeed, economic restitution and retribution will be the primary types of punishment in a system of customary law, but they may not be the only types of punishment. After all, "a fine is a [relatively] costless punishment: the cost to the payer is balanced by a benefit to the recipient. It is in this respect superior to punishments such as execution, which imposes cost but no corresponding benefit, or imprisonment, which imposes costs on both the criminal and the taxpayers" (Friedman 1979, p. 408). It is clearly possible, however, that the members of a group may hold that some offenses, perhaps intentional murder or rape, are so heinous that it is impossible to compensate for the harm inflicted. For instance, medieval Icelandic (Friedman 1979) and primitive Kapauka (Popisil 1971) legal systems considered capital punishment appropriate for some crimes. It is also possible that the rest of an offender's life will be committed to working to pay the victim or the victim's family, even if full restitution is never achieved.

Ostracism can also vary in severity depending upon the behavior that it is intended to deter. For some minor offenses or disputes, individuals may face the threat of exclusion from some forms of interaction but not others. The resulting shame or dishonor may be an effective deterrent in these minor cases. In many primitive and religious societies, mythology is invoked, for instance, and the resulting religious ostracism can be a particularly frightening threat. Obligations can be characterized as "taboos" punishable through sorcery and supernatural sanctions, or sins punishable through excommunication. For more severe offenses or disputes, an offender who refuses to participate in non-violent dispute resolution or refuses to accept a fair judgment becomes a social outcast or "outlaw." In fact, "Expulsion from the group is probably the earliest and most effective sanction or 'punishment' which secures conformity, first by mere actual elimination from the group of the individuals who do not conform while later, . . . the feat of expulsion may act as a deterrent" (Hayek 1967, p. 78). As a result of such ostracism, the individual no longer can go to his support group for protection. The plaintiff (or perhaps anyone in the group), therefore, is free to, and perhaps even obliged, to take physical revenge by killing the offender and/or taking the offender's property. Of course, the threat of such violent punishment can be a significant deterrent to illegal behavior. Indeed, similar threats apply in all legal systems, including those that exist today (Umbeck 1981). The fact is, however, that while boycott sanctions are possible, the primary impetus for accepting such rulings is positive self-interest rather than fear of negative consequences. The result can be characterized just as Mises (1949, p. 283) describes the interdependence arising in a free market: "[T]he individual is not bound to obey and to serve the overlord. [Yet] he is certainly not independent. He depends on the other members of society. But this dependence is mutual."

Another characteristic of customary law's sanctions can be predicted in light of its emphasis on individual rights. As with any private property right, the right to restitution will be transferable. An individual might call upon a sub-group (e.g., his immediate family, his religious congregation, his neighborhood) to assist him in prosecuting a strong offender, in exchange for some portion of the settlement, providing the threat necessary to induce that offender to submit to a nonviolent form of dispute resolution (Hoebel 1967; Benson 1991a). Alternatively, a marketable claim for a victim can evolve which can be sold to someone willing to pursue and prosecute the offender (Friedman 1979, p. 414). This, in turn, helps create arrangements under which those who violate the rights of the poor and the weak are pursued and prosecuted. As a customary law system

expands and evolves, victims could offer bounties or rewards, but they might simply sell the right to collect a particular fine. Specialized firms (thief-takers, bounty hunters) could arise to pursue criminals and collect restitution; or individuals might contract with firms that attempt to prevent aggression against clients, pay clients who are victimized as insurance companies do, and pursue offenders to recover the insurance payment. Marketable restitution rights increase the probability of pursuit and prosecution, thereby reducing incentives to commit intentional offenses even further.

It does not follow that violence and blood feud will be completely eliminated under customary law. If one party in a dispute perceives the cost of non-violent dispute resolution to be too high, even given the threat of ostracism, a feud may erupt. As emphasized above, institutions and incentives are developed in a customary law system in order to enhance the potential for peaceful interaction and minimize the potential for violence; but no legal system, no matter how threatening, has ever completely eliminated violence. However, in the event of a feud, customary "rules of war" also generally apply; the result can often be described as "a kind of ritual game" (Leach 1977, p. 25). If one party or the other exceeds the customary bounds of the feud, thereby imposing significant costs on others in the group, they are likely to bring down the wrath of the entire community, so feuds tend to be constrained in their scope and duration. Thus, even when violence arises, rights and obligations apply: "there is, in effect, agreement about how to disagree" (Leach 1977, p. 28).

As Mises (1985b, p. 258) emphasizes, "to deal with social groups adequately and completely, one must start from the actions of the individuals," a condition that clearly applies here. In essence, the individuals "exchange inputs in the securing of a commonly shared output," to use Buchanan's and Tullock's words [1962, p. 19]—the output is the order arising under a commonly accepted set of rules which develops into a customary system of law. But as a consequence of this exchange, total resources devoted to the production of credible threats should fall relative to what individuals acting on their own would have to invest, and the potential for interaction expands.

Changing Property Rights and the Development of Contracts in Customary Law

Customary law has been described as an example of natural law. For instance, Leach contends that

> customary law is not viewed as the recent creation of rational men but as something that was laid down by semi-divine ancestral

> law-givers in remote antiquity. The justification for conforming to custom is not that it makes sense, but that *"that is what our ancestors said we should do"*. . . . There is an implicit social contract with divine ancestors to obey the rules that they laid down. Failure to conform to conservative custom amounts to an act of sacrilege which will automatically bring about supernatural disaster. (Leach 1977, p. 31)

Equating customary law with natural law is very misleading, however. First of all, even if the rules were passed down unchanged from ancestors, those ancestors were rational humans, not gods, and they developed their rules by considering the costs and benefits of doing so. Second, mythology is important in some customary law systems, particularly among primitive societies and religious communities; but it is not relevant in others (e.g., see the discussions of commercial law in Trakman [1983]; Berman [1983]; Berman and Dasser [1990]; Benson [1989b, 1990, 1992a]). Third, the fact that mythology plays an important role in some customary law systems does not mean that the myth *actually* describes the source of the law. In fact, mutually beneficial behavior can often fit a variety of norms.[8] Fourth, and most significantly, customary law is not static. It evolves and changes as individuals adapt to meet the needs of new conditions. The important issues, then, are why did the rules develop in the first place, an issue discussed above, and why do they evolve and change, rather than how those rules happen to be explained in particular customary law systems.

As Demsetz (1967) explains, property rights will be defined when the benefits of doing so cover the costs of defining and enforcing such rights. Potential benefits of clarifying existing or developing new property rights may become evident because a dispute arises, for example, perhaps implying that existing rules do not adequately cover some new situation. The parties involved must expect the benefits from resolving the dispute and of establishing a new rule to

[8]In fact, mythology appears to be a rational development in itself. Taboos against incest are common among primitive societies, for instance. These people do not know why the offspring of incestuous relationships tend to be physically or mentally impaired but through observation, they learn that they are. Thus, in order to avoid the cost of caring for such people they decide that the gods have declared such relationships to be taboo in order to discourage them. In addition, when the costs of obtaining information exceed the benefits, it is very rational to be ignorant; and similarly, when the desired behavioral results can be obtained without incurring all of the costs of informing others of the precise reason for the behavior, then it is rational to do so. Whether the desired behavior arises because an individual is correctly informed by those knowledgeable of such things, so that he expects the economic benefits to exceed the cost of behaving differently, or if he expects a supernatural disaster if he behaves differently, the outcome is the same.

outweigh the cost of resolving the dispute and enforcing the resulting judgment, or they would not take it to the dispute resolution system. The arbitrator or mediator will often have to make more precise those rules about which differences of opinion exist, and at times even to supply new rules because no generally recognized rules exist to cover a new situation (Hayek 1973, p. 99). A dispute resolution's decision becomes a universally applied rule of customary law only if it is seen as a desirable rule by all affected parties, however (Benson 1990, 1991a, 1992a). It is not coercively imposed on a group by some authority backing the court. Thus, good rules which facilitate interaction tend to be selected over time (e.g., rules that specify or clarify private property rights), while decisions that do not turn out to establish useful rules are ignored.[9] For new rules to be accepted by the members of a group, they generally must be consistent with individuals' expectations, so they must build upon or extend existing values.

Dispute resolution is not the only source of evolving behavioral rules. Individuals may simply observe that others are behaving in a particular way in light of a new situation, and adopt similar behavior themselves, recognizing the benefit of avoiding a confrontation: "It is always an individual who starts a new method of doing things, and then other people imitate his example. Customs . . . have always been inaugurated by individuals and spread through imitation by other people" (Mises 1985b, p. 192). As a consequence of adopting such behavior, the individuals create an obligation to one another to continue the behavioral pattern. A new contract form may develop, for instance, that improves on existing forms by reducing the potential for uncertainty. Others see the benefits of the new contract form and adopt it as well, so it becomes a standard practice in such situations. Fuller (1981, pp. 224–25) explains that "the term *contract law*, therefore, refers primarily not to the law *of* or *about* contracts, but to the 'law' a contract itself brings into existence . . . If we permit ourselves to think of contract law as the 'law' that parties themselves bring into existence by their agreement, the transition

[9]This description of the evolution of customary law may appear to be quite similar to the analysis of common law that has lead several legal theorists to conclude that it produces "efficient" rules (Leoni 1961; Rubin 1977; Priest 1977; Hayek 1973, pp. 94–103). However, there are actually important points of departure. For instance, while much of common law was simply a codification of the basic norms common to Anglo-Saxon society (that is, customary law), common law was also authoritarian royal law, and therefore, even during its earliest development some aspects of it were imposed by authoritarian sources described below (Benson 1990). Footnote 24 contains related discussion.

from customary law to contract law becomes a very easy one indeed." Customary law and contract law are typically differentiated much more sharply than is suggested here. However, Fuller argues that a sharp distinction is inappropriate:

> if problems arise which are left without verbal solution in the parties' contract these will commonly be resolved by asking what "standard practice" is with respect to the issues in question. In such a case it is difficult to know whether to say that by entering a particular field of practice the parties became subject to a governing body of customary law or to say that they have by tacit agreement incorporated standard practice into the terms of the contract.
>
> The meaning of a contract may not only be determined by the area of practice within which the contract falls but by the interaction of the parties themselves after entering the agreement. . . . The meaning thus attributed to the contract is, obviously, generated through processes that are essentially those that give rise to customary law. . . . [In fact,] a contract [may be implied] entirely on the conduct of the parties; . . . the parties may have conducted themselves toward one another in such a way that one can say that a tacit exchange of promises has taken place. Here the analogy between contract and customary law approaches identity. (1981, p. 176)

The expanding use of contract and development of contractual arrangements is, in fact, a natural event in the evolution of customary law. As customary legal arrangements evolve and are improved upon, they tend to become more formal, and therefore, more contractual. In addition, as inter-group interaction develops and expands so that the trust relationships that characterize intra-group interaction do not apply, conflicts are avoided by explicitly stating the terms of the interaction *a priori*; that is, by contracting. A carefully constructed and enforceable contract can substitute for kinship or some other localized source of trust.

III.
Inter-Group Interaction: Competition, Emulation, and Cooperation

No single group is likely to develop its norms and institutions in complete isolation from other groups. Indeed, other groups generally exist in close proximity to any particular group (note that the basis for such groups can but need not be geographic proximity; other bases include kinship and religious or functional proximity, as in the "international business community"), and these other groups'

legal systems are likely to be developing in a parallel fashion. Thus, inter-group competition, emulation, and cooperation become possible.

Since voluntary associations include both the ability to voluntarily join a group, given the individual is acceptable to the group's existing membership, and the ability to voluntarily withdraw, inter-group movements are a distinct possibility (e.g., see Goldsmidt [1951]; Popisil [1971]; Peden [1977]; Friedman [1979]; Umbeck [1981]; Benson [1989a, 1990, 1991a, 1991b]). Thus, if rules and/or institutions develop in one group which differ from the rules and/or institutions in a parallel group, there will be a tendency for individuals to "migrate" to the group whose law best facilitates voluntary interaction. The coexistence of diverse parallel jurisdictions and legal systems therefore creates incentives to compete to attract or hold membership. But, as a result, existing members of all the various legal systems have incentives to adapt to their own uses many of the legal concepts and institutions of other groups which appear to be beneficial. Through imitation of desirable institutions and behavioral rules developed elsewhere, groups can avoid the potential of lost membership (and reduced beneficial interaction) to other groups; and for that reason, too, there is a tendency for the rules and institutions of each group to achieve the same degree of cohesion and sophistication as is developing in parallel systems. Not all differences need be eliminated, but standardization of many rules and institutions across similarly functioning groups is likely.

The formation of several parallel "localized" mutual support groups can take on even more functions. For example, a member of one group may wish to trade with a member of another group, but the two individuals may not expect to trade frequently so the dominate strategy is one of non-cooperation. After all, repeated-game and reputation effects are localized within a group, and there generally is no potential for a boycott sanction to be applied against someone who is not in the group.[10] It may be that there is considerable potential for mutually-advantageous interaction between the two groups as a whole, however, even though each individual within each group may not anticipate frequent interactions with members of the other group. That is, the groups of individuals as a whole may be in a repeated-game situation with one another, with fairly large potential benefits from cooperation that can be internalized, even though this is not necessarily true of any of the specific individuals in the two groups (at least, before inter-group relationships develop). If

[10]There are possibilities of inter-group boycotts, of course. Consumers as a tacitly organized group might boycott individual producers or producer groups, for instance.

members of each group recognize the benefits from inter-group interaction, then inter-group legal cooperation may evolve.

Inter-group cooperation is hindered by a significant assurance problem, however. Each individual must feel confident that someone from the other group will not be able to take advantage of him and then escape to the protection of that other group. Thus, some sort of inter-group insurance arrangement becomes desirable, as well as establishment of an apparatus for inter-group dispute resolution. For instance, in order to develop a group's reputation, the membership might bond all members in the sense that they will guarantee payment if a member is judged to be in the wrong in a dispute with someone from the other group. The mutual support group becomes a surety group as well (e.g., see Rothbard [1973]; Peden [1977]; Friedman [1979]; Benson [1990, 1992b]). Membership in a group then serves as a signal of reputable behavior to members of another group, and lack of membership serves as a signal that an individual may not be reputable. Furthermore, if a member of a group cannot or will not pay off a debt to someone from the other group, as established by an acceptable arbitrator, then the debtor's group as a whole will, in order to maintain the benefits of the group's reputation. And as a consequence, the individual for whom the group has had to pay will owe his own group members rather than someone from a separate group. In this way the boycott threat comes into play once again. Members of a group are not going to continue bonding an individual who generates debts to the group's membership but does not pay them off, after all. More significantly, however, because of the large long-term benefits of intra-group interaction, the self-interest incentives to maintain intra-group relationships come into play.

A dispute resolution apparatus is essential for inter-group cooperation to develop. A judgment involving an inter-group dispute will have to be considered to be fair by members of both groups, of course. Therefore, an equal number of individuals representing the group might serve as an arbitration board for disputes between individuals from the two groups (e.g., see Goldsmidt [1951]; Friedman [1979]; and Benson [1990, 1992b]), for example, or a mutually acceptable third party (i.e., an arbitrator or mediator with a reputation for good judgment) might be chosen (as in Barton [1967]; Hoebel [1954]; Peden [1977]; Popisil [1971]; and Benson [1990]). This provides another reason for the tendency toward standardization of customary law across parallel groups with similar functions.

A group whose members insist on strictly imposing their own morality and penalties on outsiders would probably be unable to initiate inter-group trade or other forms of beneficial interaction. And

if they were able to begin such activity, they would face continual clashes, followed by boycott sanctions by other groups whose members refuse to visit or trade with them. Indeed, if the benefits of inter-group interaction are substantial, those who hold the norms the group wishes to impose, but relatively weakly, will leave first to join other groups, and others will follow as property values and trade generated incomes decline. Thus, if the membership of a group wishes to simultaneously facilitate inter-group interaction and impose laws that differ substantially from the norm in other groups, its members have strong incentives to inform outsiders of the differences in order to avoid conflict and minimize the difficulty of maintaining non-standard laws. Part of the reciprocal agreements with other groups may be the explicit recognition of differences in laws and procedures for treating conflicts, for example. No group can effectively enforce its rules on outsiders without the support of outsiders. Rules for members of a group may be relatively restrictive, but the rules that apply to outsiders as a result of interaction will have to be moderated if the group is to survive in a free and competitive environment. This in turn implies that as inter-group interactions expand, a hierarchical jurisdictional arrangement may become necessary. For example, each localized group may have jurisdiction over disputes between its members, while disputes between members of a confederation of different groups that interact frequently are settled by some higher confederation level court, and disputes between members of even more dispersed groups from different confederations, such that individuals from the localized groups do not interact frequently but individuals from the two confederations do, may go to an inter-confederation court (e.g., see Popisil [1971] and Benson [1990, 1992b]). Note that these courts are not "higher" courts in the sense that one has some power or authority over others that allows them to overturn lower court decisions upon appeal. Rather, this is a jurisdictional hierarchy that defines the role of each court and allows for increasingly more distant interactions. This allows for differences between the customary law that might be applied within different groups *and* between groups (Popisil 1971). Indeed, Llewellyn and Hoebel (1961, p. 53) point out that the traditional (Western) bias of trying to delineate some all-embracing legal system for a society as a whole can be very misleading: "What is loosely lumped as a custom [from an all-encompassing perspective] can become very suddenly a meaningful thing—one with edges—if the practices in question can be related to a particular grouping." They emphasize that an understanding of customary law requires that groups provide the points of reference rather than some "society" as a whole (1961, p. 28): "there

may then be found utterly and radically different bodies of 'law' prevailing among these small units, and generalization concerning what happens in 'the' family or in 'this type of association' made on the society's level will have its dangers. The total picture of law-stuff in any society includes along with the Great Law-stuff of the Whole, the sublaw-stuff or bylaw-stuff of the lesser working units."

There clearly are limits to how extensive an inter-group network of cooperation can be. The limits are not fixed, however. They depend on the relative costs and benefits of information about other groups and their customary legal systems. As economic conditions change the costs and benefits of information can change, so new inter-group relationships may evolve over time. The costs of establishing inter-group legal arrangements depend in part on how "distant" the groups are from one another, where distance can be in terms of geographic space, or in terms of the behavioral norms that are relevant to the groups. While customary groups all tend to emphasize private property, the costs and benefits of establishing the rights and obligations relevant to each group can be quite different, so that different norms are applied. Members of families who join into a larger kinship group, or members of a religious or commercial community with strongly shared values, can easily have most everything go as expected because each individual's expectations about other's obligations are very accurate. Even if disputes arise (and quarreling among members of a family is certainly commonplace) they are very likely to be settled in an amicable way. On the other hand, where individuals in different groups do not share significant values, and therefore, where intra-group behavior is based on substantially different expectations than inter-group behavior must be, inter-group organizations may fail to develop. Individuals who do not interact frequently may base expectations on incorrect or prejudicial views of members of the other group, so mutual incomprehensibility is likely to prevent effective cooperation.

This discussion implies that a customary legal system is, in a sense, flawed, or inefficient. Relative to some perfect ideal, this is certainly the case. However, the ideal against which such a system must be compared in order to draw a conclusion that the system is inefficient, is, in general, unobtainable. Thus, in a realistic sense, the customary legal system is efficient. After all, it results from the interaction of maximizing individuals. Maximizing behavior means that the actions taken are never deliberately wasteful. The actions reflect individuals' weighing of their expected benefits and expected transactions costs, so the perceived gains of a decision always should exceed the perceived costs. Therefore, a decision by individuals in two

different groups not to establish cooperative legal arrangements is an efficient decision. Of course, there may be benefits that the individuals do not fully recognize, so there may be some potential benefits from a more extensive legal arrangement that are not internalized, at least in hindsight, but the fact is that uncertainty and expected transactions costs exist that may prevent the formation of an all-encompassing customary legal system. Possibly through coercion a benevolent legal authority could improve on a completely customary legal arrangement then? Friedman answered this question in the following way:

> One cannot simply build any imaginable characteristics into a government; governments have their own internal dynamic. And the internal dynamic of limited governments is something with which we, to our sorrow, have a good deal of practical experience. . . . the logic of limited government is to grow. There are obvious reasons for that in the nature of government, and plenty of evidence. Constitutions provide, at the most, a modest and temporary restraint. As Murray Rothbard is supposed to have said, the idea of a limited government that stays limited is truly Utopian. (1973, pp. 200–1)

In addition, the limit on the potential for inter-group interaction may actually be less significant than it first appears to be. After all, in reality, as Mises explains,

> Man is not the member of one group only and does not appear on the scene of human affairs solely in the role of a member of one definite group. In speaking of social groups it must be remembered that the members of one group are at the same time members of other groups. The conflict of groups is not a conflict between neatly integrated herds of men. It is a conflict between various concerns in the minds of individuals. (1985b, p. 257)

A member of several groups has obligations to other members of each group and they have obligations to him. Thus, he is in fact familiar with the behavioral rules of several different groups and is in a position to facilitate the development of inter-group ties. "Indeed, in any complex society such as ours, there are almost as many distinguishable systems of customary rules and conventions' as there are individuals" (Leach 1977, p. 28), and yet people from many of these different systems interact regularly without having to call upon any dispute resolution process (not to mention, any legal authority). Inter-group cooperation appears to be the norm rather than the exception, and it appears to be quite widespread.

It should also be noted that an all inclusive legal system has some very undesirable results because it eliminates the potential for competition and emulation. For instance, if a dispute arises with someone else who is also a member of some of the same groups, they might choose among the groups' alternative dispute resolution processes. Indeed, the availability of alternative dispute resolution processes reinforces the tendency of customary law toward fair dispute resolutions. If one forum is biased, a disputant can demand the use of an alternative. A compromise is to use a forum that is fair. As Berman explains,

> The very complexity of a common legal *order* containing diverse legal *systems* contributes to legal sophistication. Which court has jurisdiction? Which law is applicable? How are legal differences to be reconciled? Behind the technical questions lay important political and economic considerations. . . . The pluralism of . . . law, . . . has been, or once was, a source of development, or growth—legal growth as well as political and economic growth. It also has been, or once was, a source of freedom. (1983, p. 10)

Berman includes the "or once was" phrase in recognition of the fact that diverse legal systems are increasingly being subjugated and centralized under the authority of coercive state governments.

IV.
The Conflict Between Custom and Authority

Short-run considerations can dominate under certain circumstances, of course (Mises 1985b, p. 236), and while individuals have strong incentives to cooperate and avoid conflict when they are likely to interact frequently (e.g., when long-run considerations dominate), they have very different incentives when "the discipline of repeated dealings" does not apply (e.g., when short-run gains appear to outweigh long-run benefits). Indeed, when wealth enhancing voluntary interaction is unlikely (or when the gains are not likely to be very large), individuals may have stronger incentives to take wealth away from the others rather than attempt some reciprocal arrangement for mutual satisfaction.[11]

[11]For instance, as Tullock (1985, p. 1079) notes, once a person's reputation is lost, there is virtually no reason to behave cooperatively in the future, because the cost of rebuilding a reputation is extremely high. Therefore, such a person has incentives to become a thief or to "con" people.

Note that wealth or well-being "does not refer only to concerns commonly called egoistic but comprehends everything that appears to an individual as desirable and worthy"; nonetheless, the "fact that most people are eager to get more tangible good is a datum of economic history" (Mises 1985b, pp. 206–7).

The taking of wealth will be resisted, of course, if the potential victim feels that he is strong enough to resist, so violent confrontation is likely, particularly if the potential loser is a member of a support group. After all, one form of mutually beneficial interaction within the groups described above is in cooperative defense against outsiders, since an important internal function of these groups is the protection of private property, and such a taking by an external aggressor is a theft. In order to reduce the cost of such violence, those seeking transfers must amass sufficient strength to coerce compliance.

One way to reduce the potential for resistance to a transfer effort is to employ a "professional army." However, if an individual can persuade others of a like mind to cooperate and share the cost in a taking effort (e.g., by serving in an army or contributing financial support for it) in exchange for a share of the transferred wealth, then that individual lowers his own costs. Thus, there are incentives to develop cooperative mechanisms for taking and transferring wealth. Of course, when some individuals form groups for the purpose of taking from others, then others have incentives to expand their groups which share the cost of protection. Indeed, many of the historical examples of localized support groups whose internal legal arrangements can be characterized by the customary legal system described above, were simultaneously involved in warfare with other groups (e.g., see Popisil (1971); Benson (1989a, 1990, 1991a, 1992b); Hoebel (1954, 1967); and Peden (1971]). In European tribal groups, for example, Kingship initially developed for purposes of warfare (Benson 1990, 1992b). As kingship developed, a centralized hierarchical structure of top-down command also developed since this institutional arrangement proved to be the most effective for the purposes of warfare.[12] During these early developments, however, kings had no law-making or law-enforcing authority.[13]

[12]It does not follow that every kingdom was constantly at war. The competitive process of emulation of successful military institutions, arms built up, and strategic alliances between kingdoms, might maintain relatively equal levels of military power for some time, thereby deterring aggression.

[13]Despite the focus on nation-states and their governments, this theory of authoritarian law is not simply a restatement of the "rent-seeking" or "interest-group" theory of government. Perhaps two points will help to clarify this. First, for reasons explained below, many rules of conduct enforced by governments' legal apparatus are codified custom rather than new rules imposed by some authority. Thus, an examination of any government's law will reveal many aspects which may not fit a transfer theory. Indeed, governments have functions which do not involve internal legal order, some of which may be consistent with a transfer theory (i.e., warfare), but some may not be. Second, as Mises (1985a, p. 47) recognizes, "not every apparatus of compulsion and coercion

Authoritarian Law

Military conquest means that different groups are forced to become sub-groups within a collective kingdom ("kingship" will be used to describe all such arrangements, and the area over which a military leader exerts authority will be called a "kingdom"). As more sub-groups are subjugated by a single centralized military authority, the potential for taking from one sub-group and transfer to another *within* that Kingdom arises. The evolution of kings' authoritarian roles in internal law making and enforcement (i.e., legislation, adjudication, and law enforcement affecting relationships within the Kingdom as apposed to external relations with other kingdoms), is completely analogous to the development of the external role of Kingship (Benson 1990; 1992b). That is, a legal system emanating from a centralized hierarchical authority, referred to here as "authoritarian law," has as its primary functions the development and use of rules and institutions for taking wealth from some and transferring it to others, and for discrimination among sub-groups on the basis of their relative power in order to determine gainers and losers. Indeed, in Europe, authoritarian legal functions were taken on by the kings' military hierarchy initially, until the increasing demands for

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is called a state. Only one which is powerful enough to maintain its existence, for some time at least, by its own force is commonly called a state." Historically, powerful entities that were not geographically defined states or kingdoms, such as the medieval Roman Catholic Church, have been able to take property rights from others through the use of authoritarian legal institutions (Berman 1983). Even today, there are other sources of such law. Consider modern organized crime, for example. These organizations establish rules of conduct for members backed by enforcement mechanisms and sanctions. Some of their rules and institutions have evolved over time as customary law, through voluntary interactions of members, but they also use an enforcement apparatus and threat of sanctions to extort payments from individuals who do not want to voluntarily interact with them (e.g., "protection rackets"). Thus, organized crime is like kingship and modern representative governments in that it uses authoritarian institutions to take from some individuals within its sphere of influence for the benefit of those with power. The scope of authoritarian law therefore reaches beyond governments' legal arrangements, and it need not cover every aspect of modern government. Nonetheless, "whatever functions it may assume, the state is always characterized by the compulsion and coercion exercised" (Mises 1985a, p. 47) while non-state entities are not necessarily so characterized.

On a related issue, recall the introductory discussion regarding Mises's view of the necessity of a coercive state. A group ruled by customary law need not constitute a state, as typically conceived. Indeed, it might be appropriate to characterize the institutions and processes of the customary law with Buchanan's term of "ordered anarchy" (1975, p. 180). However, von Mises (1985a, p. 93) argues that "The right and true state . . . is the state in which I or my friends, speaking my language, and sharing my opinions, are supreme. All other states are spurious." Thus, Mises appears to mean that at least some "customary law" group is the appropriate state, although he also rejects the idea of ordered anarchy (1985a, p. 48).

authoritarian law led to its own specialized bureaucratic hierarchy.

In many nation-states, rule by kingship has been replaced by other sources of authoritarian law, such as elected representative bodies. Nonetheless, "The essential characteristic features of state and government . . . are present both in despotic and in democratic governments" (Mises 1985a, p. 47). Authoritarian law, whether imposed by kings or an elected representative assembly, involves the taking of wealth from relatively weak sub-groups in order to transfer it to relatively powerful sub-groups, or "interest groups" in reflection of the self-interest motives of the decision-making authorities (Benson 1990; 1992b): the distinction is in terms of who gets what, "not in the incentives and motives" (Mises 1985a, p. 5; also see Hayek 1973, p. 3). Authoritarian decision-makers discriminate between competing interest groups on the basis of what they can give to the decision-maker.[14] The self-interest motives of government decision-makers *must* be recognized in the context of an authoritarian transfer process. Kings were clearly not simply impartial transfer mechanisms. They demanded (took) transfers for their own benefit when they felt they had sufficient power, and even when they entered an exchange, thereby transferring to others, the support gained generally enhanced their own wealth and power relative to what it would have been in the absence of the exchange.

Authoritarian Law and Property Rights

The internal taking/transfer mechanisms all involve property rights alterations to benefit some at the expense of others. Taxation is the taking from a resource owner of part of the right to the income derived from productive uses of property (including labor services), for example.[15] Another fairly obvious transfer occurs when property

[14]In competition between national governments, the determinant of wealth transfers is military strength. Military power can be an important discriminatory criterion in determining internal wealth transfers as well. The control of military forces by earls and barons was one of the most important considerations in early development of authoritarian law under the kingship form of government in England (Benson 1990, 1992b), and military power is still a major factor in many non-western countries (e.g., the Philippines, Nicaragua, El Salvador, Lebanon, Iraq, South Africa, Yugoslavia, etc.). The threat and use of military-like terrorism is also an important political factor, and the ability to *threaten* political disruption remains an important political consideration everywhere. Other bases for sub-groups' political power may be economic power, the number of members (perhaps because of the potential for physical force, but also because of the votes it can muster in a representative democracy), and the ability to organize and voice demands in a political arena.

[15]Indeed, under kings, a major purpose of taxes and other authoritarian developments in law was extraction of revenue to support the external function of kingship—wealth transfer through warfare. As Mises (1985a, p. 3) argues: "Foreign policy and

of some kind is confiscated or someone is forced to sell property for less than its value in a voluntary exchange, and then the property is given to or used for the benefit of others.[16] Other rights modifications simply place limitation on a person's use of his property. For instance, a monopoly franchise simultaneously grants an exclusive right to produce and restricts or attenuates rights to the use of other individuals' resources who might wish to enter that market. All such transfer activities are completely analogous to theft (Tullock 1967).

An important implication of an authoritarian modification in property rights, is that there will be a series of adjustments through time. Some of these changes are predictable. For instance, once sufficiently organized power is exerted to cause decision-makers to make an authoritarian change in a rights assignment, those who would be harmed by the change must either organize and apply counter pressure, or resign themselves to being worse off. The same "prisoners dilemma" arises in this internal political struggle for property rights as arises in the external struggle between governments.[17] Thus, there is a potential for spiralling competition between interest groups much like the spiralling arms build up that typically characterizes inter-governmental competition.[18] As the relative strength of interest groups change, the magnitude and direction of transfers change. Of course, as a new interest group successfully organizes, it does not follow that the original rights modification will be reversed. After all, that would harm the previously organized and already powerful group. Some modification of the earlier change is possible, but a more probable response is that the authority will grant some alternative favorable treatment to compensate the new group for its earlier losses. This change is likely to harm an as yet unorganized group.[19] That group

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domestic policy are closely linked together; they are but one system; they condition each other."

[16]Property rights transfers can alter the behavior of those directly impacted in ways that benefit other groups as well, so not all beneficiaries need be obvious.

[17]Recall footnote 11, and recognize that once a sub-group establishes a reputation as a political interest group intent on achieving transfers, the probability of that group's becoming an effective part of a cooperative customary law system is very small, because the cost of rebuilding a reputation is extremely high.

[18]This kind of competition implies that resources are "wasted" in the sense that they are used up to "produce" wealth transfers rather than to produce additional wealth.

[19]Often the changes in authoritarian laws and institutions are slow, or marginal, as with customary law, but at times they can be large. Indeed, the competition for authority can turn violent, if the authority attempts to impose a relatively large transfer at the expense of a potential rival for power. Thus, both evolution and revolution shape the development of authoritarian laws (Berman 1983). But a new authority is not likely to radically change the basic institutions of the legal system. After

then has relatively strong incentives to organize and seek rights modifications. Competition leads to emulation, of course, and at times competing interest groups might cooperate with one another in an effort to defeat yet another group. The repeated "redistributive game" is often one of coalition formation and splitting (Jasay 1989, pp. 117–21). Thus, demands for authoritarian rights modifications grow over time.[20]

Another series of adjustments arising from an alteration in property rights is also predictable. Legal authorities can never anticipate all of the consequences of their rulings (Hayek 1973, p. 51; Mises 1985b, pp. 195–96, 378). "Yet every action. . . . affects the course of future events" (Mises 1985b, p. 195). After all, property rights provide incentives which condition behavior, so a change in rights changes behavior. The customary legal structures described above emphasized private property and individual rights. Since authoritarian law produces rights transfers, it follows that at least initially, authoritarian legal developments imply restrictions on private property and individual rights (later, interest groups may form which successfully press for reestablishment of certain rights, of course—those who suffer loses tend to press for a return to a previous rights structure (Benson 1990, 1992b). At any rate, it is clear that under authoritarian law, property rights are permanently vulnerable to authoritarian alterations. When rights are significantly altered through authoritarian changes in law, or when they become sufficiently tenuous due to frequent legal changes, individuals' behavior changes. Given a loss of rights, for instance, individuals will quit performing previously worthwhile functions. If the functions are demanded by powerful interest groups, the legal authority will either try to force the previous behavior, or directly produce the functions (Benson 1990, 1992b).[21]

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all, those institutions developed for the purpose of transferring wealth and they can serve one authority as well as another. As Mises (1983, p. 120) explains, "the handling of the government apparatus of coercion and compulsion, must necessarily be formalistic and bureaucratic. No reform can remove the bureaucratic features . . ."

[20]There are other reasons to expect increasing numbers of rights modifications. Substantial benefits typically must be anticipated for individuals to incur initial organizational costs, but once organized, the costs of demanding more benefits are relatively low. Also, as power increases goals expand.

[21]As English Kings began to develop a role in law enforcement, they began to shift the form of "punishment" from victim restitution to a fine paid to the king. The right to restitution was one important incentive underlying the reciprocal arrangements for protection, insurance, pursuit, and adjudication. The taking of this right meant that reciprocal arrangements began to breakdown, and ultimately, kings had to create a separate hierarchical enforcement apparatus (Benson 1990, 1992b).

Authoritarian Institutions

Authoritarian decision-makers could conceivably respond to growing interest group demands strictly through legislation, and enforce the resulting law personally, but the fact is that a decision-making authority's own time and resources are limited, so increased demands ultimately force delegation of certain responsibilities to lower levels of authority: a bureaucratic system must emerge "in the administrative apparatus of every government the sovereignty of which stretches over a large area" (Mises 1983, p. 15).[22] This is particularly true in the area of policing. After all, "while there is usually little need for external force to uphold the customary law, the authoritarian law . . . needs for its enforcement the prestige and influence or even the intimidation and physical force of the authority and his supporting minority" (Popisil 1971, p. 344).

When authoritarian law applies and a dispute arises, litigants are generally trying to manipulate the existing rights structure. Wealth transfers are the goal of one party in a dispute and avoidance of the transfer is the goal of the other. The dispute might be taken before a third party tribunal to be resolved. Under these circumstances, disputes are negative sum competitions: one party wins, another loses, and both parties incur dispute resolution costs. They are, therefore, much more adversarial in nature than potential positive sum customary law disputes (i.e., clarification of private property rights to generate long-term benefits), and as a result, the authoritarian institution of dispute resolution will be different from the institutions of customary law. Adjudication, in which a judge is backed by coercion (a police force, prison system, executioner, etc.) to force the disputants into court and impose his decision, is generally necessary when negative sum disputes are involved. The authority may actually take on an adjudication role, as English kings did, for instance, (and use military forces to back his rulings) although a judicial (and policing) bureaucracy is certain to arise. As the scope of legal authority expands and property rights attenuations increase, the cost of judicial activities, in terms of time and effort, become too high for the authority.

[22]There are at least two important consequences of such a hierarchy of delegated authority: (1) as these bureaus increase in number and/or size the ability of higher decision-making authorities to monitor their actions decreases, the power of bureaucrats grows relative to the power of those they supervise, and those they originally obtained their authority from (Mises 1983, pp. 54, 80); and (2) as their discretion increases and they grow in size they generally will demand more rights modifications to enforce (Benson 1990), thus resulting in wealth transfers to bureaucrats (i.e., larger budgets and/or more power).

Since authoritarian law transfers wealth from the weak to the powerful, a powerful individual or group often can induce the authority to serve as a representative in the litigation process. Indeed, the legal authority often benefits from the transfer, and while the authority might be in a position to simply take the desired property, there are strong incentives to make "legitimate" the taking by using legal institutions, in order to minimize the potential for a public outcry and organized resistance, and in order to offer the loser a non-violent arena for protest. Therefore, in matters of authoritarian law the authority often takes on the role of prosecutor before his own judicial bureaucracy and then, as legal activities increase, develops a prosecutorial bureaucracy for that purpose. Thus, as dispute settlement becomes one of deciding who gets what in a negative sum transfer process, rather than a clarification of property rights, "the true plaintiff becomes the victim, [and] the state becomes the plaintiff" (Nader and Todd 1978, p. 38). Indeed, so called "victimless crimes" become increasingly likely as powerful groups demand that new "offenses" be defined as criminal because they offend the "morality" or transfer potential of those with power. Clearly, restitution backed by ostracism can no longer be the relevant sanction since the victim is the loser. Therefore, sanctions take on other forms: capital punishment, confiscation of property, fines paid to the authority, and imprisonment.

Of course, given the expected cost of adjudication, as well as the cost of sanctions which can be imposed through coercion, "extrajudicial processes will develop . . . ; so will self-help procedures" (Nader and Todd 1978, p. 38). The expected loser may be willing to negotiate an out-of-court settlement, for instance, or accept a mediator or arbitrator. The impetus for these extrajudicial processes is similar to the impetus under customary law in that they are means of avoiding costs. Under customary law, they are used to avoid the cost of violence, however, while under authoritarian law they are used to avoid the cost of adjudication. As explained below, however, a legal authority has incentives to monopolize the legal system, so arbitration and other sources of non-adjudicated dispute resolution may be discouraged by making it more costly or even "illegal" (e.g., see Trakman [1983]; Benson [1989b, 1990, 1992b]). But if the potential loser perceives the expected cost of avoiding adjudication and of using extrajudicial processes to be greater than the expected cost of "self-help" (i.e., violence against the other party), then that also becomes a viable option. This self-help is no longer constrained by the threat of ostracism. If the physical and/or economic sanctions threatened by the authority are less effective than the threat of ostracism by a customary law group, then violence can increase. As policing bureaucracies

are expected to enforce increasing numbers of laws (e.g., such as those against victimless crimes), for instance, the probability of being caught by an imperfect policing system is lowered. Indeed, if scarce policing resources are also increasingly less available to control customary offenses against persons and property, such offenses can also increase, and self-help solutions are likely to follow.[23]

Custom versus authority

Authoritarian law requires a substantial amount of localized monopoly power in order to truly impose law that generate transfers; as Mises (1985a, p. 46) notes, "A state without sovereignty is a contradiction in terms." When people can choose between alternative sources claiming legal authority, for example, then these legal arrangements have to compete for the attention of potential subjects. Thus, the supposed authority really has little authority, since individuals will be able to opt for an alternative legal system whenever there is an attempt to take wealth from them without sufficient compensation. As a result, those who wish to generate wealth transfers by establishing some authoritarian rule will have to claim to be the source of all law, whether that truly is the case or not. Competition leads to emulation, of course, and at times competing legal authorities might cooperate with one another in an effort to defeat yet another rival for authority. The changing tides of cooperation and competition between cannon law of the Roman Church, royal law of developing kingdoms, and feudal law of the manors in medieval Europe were very important in shaping Western legal tradition (Berman 1983). Coalitions do not last, however: ultimately authority requires monopoly.

Authoritarian legal systems, with their centralized power, also attempt to absorb customary legal systems over time, simultaneously adopting many aspects of the customary system and altering others. The reason for this absorption is the same as the reason for competing with alternative claimants to legal authority: an effective authority must be an exclusive legal monopoly in some area. In addition, as Mises explains:

> people have been eager to falsify historical evidence and to misrepresent the course of events. The endeavors to mislead posterity about what really happened and to substitute a fabrication for a

[23]Police resources have been shifted to control drug crimes, for example, and property crime has been less effectively deterred so property crime has risen significantly (Benson et al. 1992).

> faithful recording. . . . were often prompted by the [falsifiers'] desire to justify their own . . . actions from the point of view of the moral code of those whose support or at least neutrality they were eager to win. (1985b, pp. 291–92)

Thus, Hayek (1973, p. 126) suggests that as "the enforcement of law [became] regarded as the primary task of government, it was natural that all the rules which governed its activities came to be called by the same name [law]. This tendency was probably assisted by a desire of governments to confer on its [authoritarian] rules of organization the same dignity and respect the [customary] law enjoyed." Furthermore, beneficiaries of the authoritarian transfer process support and encourage this falsification and absorption effort of the authoritarian decision-making institution.

In this regard, Kings claimed exclusive "divine rights" as they attempted to impose legal authority. Authoritarian law also evolves "naturally" from the self-interested behavior of individuals, after all, so it is not surprising to find the concept of natural law being invoked to support authoritarian legal arrangements, just as similar myths are evoked to explain naturally evolving customary law. Indeed, while mythology is often seen as a characteristic of customary law, it may play a more significant role in authoritarian law. Legal positivism is, in fact, a convenient "myth" for those who want to assert the control of a nation's authoritarian legal system.

The myth of legal positivism is clearly revealed when law and justice are equated, as they often are by the backers of a centralized legal system. Centralized authority has increasingly claimed to be the only source of law, but as MacCallum notes, the result is that

> There is in the public sector of our society . . . an organization of force which in collecting its necessary revenues and carrying out its operations contrasts sharply with the proprietary norms. Western society suffers a schizophrenia in the public field whereby the same agency that provides wanted public services also performs such public dis-services in the course of its operations and acts so irresponsibly in other ways as to be cannibalizing the society from which it springs. Its system of coercions and its irregular administration of rules deter, demoralize, and drain the resources of those engaged in economic tasks. Consequently the very word *government* has ambiguous connotations. In one breath it calls to mind an image of benign public service, and in the next, a threat to the continued existence of the community. (1964–65, p. 58)

The apparent "schizophrenia" in government arises because of the conflict between the rules and institutions of custom and authority (or "property and sovereignty"). Yet, so pervasive are the processes of authoritarian absorption of law that Fuller suggests that (also see Mises 1983, p. 4):

> the tendency is to convert every form of social order into an exercise of the authority of the state . . . Legislation, adjudication, and administrative direction, instead of being perceived as distinctive interactional processes, are all seen as unidirectional exercises of state power. Contract is perceived, not as a source of "law" or social ordering in itself, but as something that derives its whole significance from the fact that the courts of the state stand ready to enforce it. (Fuller 1981, pp. 156–57)

Customary rules and institutions which are relatively efficient evolve to replace those which are less efficient. Since authoritarian law often evolves to replace or at least absorb and build upon customary rules and institutions, some observers might contend that the authoritarian system must be more effective. While it is true that "everything that happens is the necessary sequel of the preceding state of things" (Mises 1985b, p. 77), it also follows that the legal institutions which evolve to facilitate involuntary transfers will be quite different from those which characterized the customary law systems detailed above. It is quite conceivable that authoritarian legal institutions which are relatively ineffective will be replaced by more effective institutions through a similar process to that which characterizes the evolution of customary law and its accompanying institutions. The evolutionary processes themselves need not be different, however, for outcomes to be quite different. Mises (1983, p. 52) notes "Government efficiency and industrial efficiency are entirely different things," and in the same fashion, while customary and authoritarian legal institutions could be equally effective at facilitating their purposes, those purposes are different.[24] As Mises (1985b,

[24]Leoni (1961, p. 17) notes that authoritarian legislation may deliberately or accidentally disrupt homogeneity by destroying established rules and by nullifying existing conventions and agreements that have hitherto been voluntarily accepted and kept. Even more disruptive is the fact that the very possibility of nullifying agreements and conventions through supervening legislation tends in the long run to induce people to fail to rely on any existing conventions or to keep any accepted agreements. On the other hand, the continual change of rules brought about by inflated legislation prevents it from replacing successfully and enduringly the set of nonlegislative rules (usages, conventions, agreements) that happen to be destroyed in the process.

pp. 48–49) emphasizes, one of the primary underpinnings of the natural law doctrine is valid: "the idea that every . . . law of a country was open to critical examination by reason." The problem with the advocates of the doctrine of natural law is that they fail to recognize what the appropriate standard of comparison is. The standard is not some set of pre-ordained natural laws, but rather, it "must be found in the effects produced by a law" (Mises 1985b, p. 49). Law can facilitate voluntary interaction or involuntary transfers; clearly this is a standard of comparison. Indeed, Mises (1985b, p. 54) maintains that the "ultimate yardstick of justice is conduciveness to the preservation of social cooperation."

Given the undesirable consequences of authoritarian law for large numbers of individuals, it is not surprising to find that in no case has the power of the authority become absolute (Leach 1977; Mises 1985b, p. 374). In fact, in some cases, the rise of authoritarian law has been successfully resisted to a substantial degree. Resistance to legal authority is likely to be most effective where the benefits generated through voluntary interaction are vary large and/or the relevant group interacts across the jurisdictions of different authorities so that inter-jurisdictional competition occurs. Thus, the international merchant community of medieval Western Europe is one such example (Trakman 1983; Berman 1983; Benson 1989b, 1990, 1992a), and it was from the resulting system of values and customary law that modern commercial law, the backbone of international trade, emerged. Indeed, modern international commercial law which evolved from this medieval legal system, remains as a largely voluntarily produced and enforced system of customary law, despite many attempts by various coercive governments to subjugate it over the centuries (Trakman 1983; Berman and Dasser 1990; Benson 1989b, 1990, 1992a).

Many other groups which started with customary law systems did not achieve a market order, however. The fact is that at some point

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Recall that Leoni and others (see footnote 9) view judge made law to be fundamentally different from legislation. A sharp distinction is inappropriate, however (Benson 1990). When a coercive authority's judges set a precedent, the resulting rule becomes enforceable law for *everyone* in the society whether it is a mutually beneficial law or not. And like authoritarian legislation, authoritarian precedent can make major alterations in law without the consent of all parties affected. Thus, as Mises (1983, p. 16) suggests, common law has also failed to resist the arbitrariness of centralized, bureaucratic management of legal affairs. The resulting uncertainty about the longevity of rights is a significant source of allocative inefficiency. In contrast, under customary law, an inefficient dispute settlement might arise, but if other parties recognize this the settlement does not become a universal rule of customary law. This suggests that efficient rules are relatively more likely to evolve in customary law than in authoritarian law, including judge made law.

many of these evolutionary processes have been interrupted by coercive forces, either from internal or external power bases, before a market order was able to emerge. The interruption can be abrupt, as through military conquest, or gradual, as through a gradual breakdown in the incentives to voluntarily interact for mutual gain (and the resulting breakdown of these incentives' accompanying norms and institutions), as authoritarian institutions expand their scope. The evolution of rules and institutions is an ongoing process, however, characterized by a continuing conflict between custom (voluntary arrangements) and authority. In some cases custom dominates and the authoritarian powers of government are limited or even diminished, as during the "liberal" era of much of the nineteenth century in the United States, Britain, and some parts of Europe (and apparently today in parts of Eastern Europe). But the fact is that "government becomes liberal only when forced to by the citizens" (Mises 1985a, p. 58). When citizen resistance is not strong enough, authority expands its scope, as it has in most of the world during most of the twentieth century. Indeed, a combination of custom and authority virtually always exists in any legal system. However, just as Mises (1985a, p. 241) convincingly argues that "It is a delusion to believe that planning and free enterprise can be reconciled," it is similarly true that authoritarian government's control of the legal apparatus is incompatible with the establishment of the freedom that arises under customary law. The objectives that underlay these two different sources of law are inconsistent, so no stable "equilibrium" relationship between the two will ever arise.

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