

PUBLIC AND PRIVATE ORDERING AND THE PRODUCTION OF LEGITIMATE AND ILLEGITIMATE LEGAL RULES

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INTRODUCTION

Among the oldest questions in legal philosophy are those asking where law comes from and what makes it legitimate. Central to this discussion is the distinction between law as a legitimate source of social ordering and law as an illegitimate demonstration of raw state power. The purpose of this Article is not to contribute to the important debate about what makes law legitimate or illegitimate. Rather, the purpose of the Article is to make three observations about legal rules that, I believe, will shed some light on the issue of the nature of law.

The first observation is that civil societies generate both legitimate and illegitimate legal rules. At first blush, it might seem that there are two sorts of legal systems, those that generate legitimate rules and those that generate illegitimate rules. But, while it is true that some legal systems are clearly more legitimate than others, it is important to recognize that even highly legitimate legal systems (such as that of the United States) often generate legal rules that one can only describe as illegitimate. Similarly, even an illegitimate legal sys-

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tem (such as that of Germany during the Nazi era) will generate perfectly legitimate legal rules, such as the prohibition against murder.

Second, the production of legal rules by legislatures generally is not linked to the demand for law by the relevant parties. In other words, laws are not supplied because society legitimately needs them, but because the outcomes that private ordering spontaneously generates often do not serve the interests of the politicians, legislatures, and special interest groups that are uniquely able to supply law.

The final, and most important, observation made in this Article concerns the inherent indeterminacy of efforts to categorize legal rules as legitimate or illegitimate. In a legal system that has the trappings of legitimacy and that produces both legitimate and illegitimate legal rules, it is simply not possible, except in extreme cases, to "prove" the legitimacy or the illegitimacy of a particular rule. The problem is that politicians, interest groups, and bureaucrats have strong incentives to categorize the legal rules they make as legitimate even when they are not. Lawmakers of all stripes have an incentive to falsely categorize illegitimate legal rules as legitimate in order to lower the political costs to themselves of passing illegitimate rules. Although groups that suffer from the existence of illegitimate rules may complain, the groups that benefit from such rules will come to the defense of these rules. This problem is exacerbated by the fact that the groups that defend such rules are likely to be better organized than the groups that are harmed by such rules. The fact that, inevitably, there will be those that complain even about legitimate rules makes the problem even worse.

Two important consequences flow from this Article's observation about the origin and nature of legal rules. First, the theory presented here about the impossibility of distinguishing legitimate from illegitimate legal rules suggests important roles for process and structure in the legal system. It is possible to design a *procedural system* and a *structural* (or constitutional) *system* that tend to winnow out illegitimate legal rules and to preserve legitimate legal rules even though it is impossible to distinguish, as a substantive matter, those rules that are legitimate from those that are not. Specifically, as I have argued elsewhere,¹ certain rules of statutory interpretation, as well as other requirements of procedural justice,² tend to promote the creation of legitimate legal rules at the expense of illegitimate rules. Other structural features of a legal system, such as the separation of powers, the

¹ See Jonathan R. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 227 (1986).

² See H.L.A. HART, *THE CONCEPT OF LAW* 156, 202 (1961) (discussing guidelines tending to preserve the integrity of the judicial process); JOHN RAWLS, *A THEORY OF JUSTICE* 236-39 (1971) (listing the ideals "which laws are expected to approximate").

independent judiciary, and the bifurcated legislature (upper and lower houses), also serve to increase the percentage of legitimate legal rules as a fraction of the total rules produced by a legal system. Second, because private ordering tends to produce generally legitimate legal rules, while public ordering produces both legitimate and illegitimate legal rules, there is a strong argument for a "meta-rule" that prefers private to public ordering.

Part I of this Article discusses the concept of the legitimacy of legal rules and the process through which both legitimate and illegitimate legal rules are created. Part II of the Article discusses the supply and demand of legal rules and explains why even legitimate legal systems create illegitimate, as well as legitimate legal rules. This discussion is followed in Part III by an explanation of why it is impossible to distinguish legitimate from illegitimate legal rules.

Parts IV and V of this Article discuss the practical consequences of the analysis presented. In particular, they argue that merely because it is impossible to distinguish between legitimate and illegitimate legal rules does not mean that nothing can be done to affect the mix of good and bad law in society. Rather, the structural and procedural rules that provide the framework for the creation and implementation of substantive legal rules can critically determine the mix of legitimate and illegitimate laws. Part IV also contains a discussion of private ordering. Building on the important work of Robert Ellickson,³ who shows that certain groups can generate private norms that maximize the general welfare of the group,⁴ I conclude that the procedural and constitutional rules that structure society should reflect a bias towards private-ordering.

I

FORMAL AND INFORMAL LEGAL RULES

"But though no other nation has ever had any written whaling law, yet the American fishermen have been their own legislators and lawyers in this matter."⁵

In every society, people are governed by an extremely complex web of formal and informal rules, norms, and constraints. This web begins with family custom; it stretches to religious tenets, codes of professional ethics, and standards of industry behavior, and extends all the way to formal, substantive legal rules. All of these rules constrain

³ ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991).

⁴ *Id.* at 167-83 (discussing a hypothesis of welfare-maximizing norms).

⁵ HERMAN MELVILLE, *MOBY DICK* 506 (Charles Feidelson, Jr. ed., The Bobbs-Merrill Co. 1964) (1851).

human action in some way, and all of them provide incentives and disincentives for people to do various things.

Indeed, in light of the myriad sources of legal constraints on human action, it is worth considering, at least briefly, why there is a need for the state to supplement the rules that nongovernmental action has already generated. Families generate legal rules in order to solve disputes within themselves. The rules are highly customized to the particular needs of the group. As the scope of the application of a legal rule increases, so too does the probability that the group will apply it in situations that are inappropriate.

Professor Ellickson identifies five factors (that he calls "controllers") that "may be sources of both rules of behavior and sanctions that back up those rules."⁶ Those rules of self-control that emanate from persons themselves are rules of "personal ethics."⁷ Those rules that develop in the course of negotiations with others are "contractual" restrictions.⁸ Those rules that come from social forces are "norms."⁹ Those restrictions that come from organizations are "organization rules."¹⁰ And finally, the rules that emanate from government are laws.¹¹

Professor Ellickson makes a powerful case for the proposition that legal theory consistently overemphasizes the role of law.¹² Over a very wide range of human interaction, the content of the relevant legal rules simply does not matter very much. People do not bother to learn the underlying legal rules that affect their actions and rely instead on norms and customs to govern their behavior. In his seminal investigation of the behavior of business firms in Wisconsin, Professor Macaulay found that informal norms of fair dealing (particularly that "[c]ommitments are to be honored" and that "[o]ne ought to produce a good product and stand behind it") play as large a role as law in governing firm behavior.¹³

Similarly, the thesis that norms are an important source of constraint on human action finds support in the work of Elizabeth Hoffman and Matthew Spitzer.¹⁴ Hoffman and Spitzer conducted a series of experiments to see how people negotiated in a game in which they

⁶ ELLICKSON, *supra* note 3, at 126.

⁷ *Id.* at 127 (italics omitted).

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 126-27.

¹² *Id.* at 137-38, 280-81.

¹³ Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 63 (1963).

¹⁴ Elizabeth Hoffman & Matthew L. Spitzer, *Entitlements, Rights, and Fairness: An Experimental Examination of Subjects' Concepts of Distributive Justice*, 14 J. LEGAL STUD. 259 (1985).

initially received unequal monetary entitlements.¹⁵ They found that a set of norms, which they described as “Lockean” ethics, governed the conduct of most players in the two-person experiments, designed to examine how people bargained over monetary proceeds from a game.¹⁶

There are a variety of explanations for why informal norms develop and for why law is so often irrelevant. All of these seek to explain why people cooperate and help each other, even when it may not be in their narrow, short-term interest to do so. One explanation is purely Darwinian: in a world of scarce resources, groups that cooperate for mutual gain have better survival possibilities than those that do not. As Friedrich Hayek observed:

[W]e cannot reasonably doubt that [our aims and] these values are created and altered by the same evolutionary forces that have produced our intelligence. All that we can know is that the ultimate decision about what is good or bad will be made not by individual human wisdom but by the decline of the groups that have adhered to the “wrong” beliefs.¹⁷

Professor Ellickson tends to doubt the explanatory power of purely evolutionary accounts regarding the power of norms of mutual cooperation. His doubt stems from the fact that, although honesty and other cooperative norms might be good for groups as a whole, “defectors,” i.e., dishonest people preying off the honesty of others, will prosper in honest communities because such dishonest people will be “surrounded by easy marks.”¹⁸

The problem with Professor Ellickson’s analysis, in my view, is that he falsely assumes that the honest people are “easy marks,” that is, they are unable to identify and shun the dishonest people.¹⁹ Contrary to Ellickson’s analysis, Robert Frank observes that, in fact, the inclination to keep one’s promises increases one’s survival possibilities.²⁰ Moreover, it is widely known that people teach their children to keep their promises. If, as Professor Ellickson suggests, it were better for the individual or family group to break promises with outsiders, then parents would not instill in their children the norm that they should not break their promises.²¹ For Professor Ellickson, a better explana-

15 *Id.*

16 *Id.* at 280-84.

17 FRIEDRICH A. HAYEK, *THE CONSTITUTION OF LIBERTY* 36 (1960).

18 ELLICKSON, *supra* note 3, at 152.

19 *Id.*

20 Robert H. Frank, *If Homo Economicus Could Choose His Own Utility Function, Would He Want One with a Conscience?*, 77 *AM. ECON. REV.* 593, 594-96 (1987).

21 *See, e.g.*, Steven N.S. Cheung, *The Fable of the Bees: An Economic Investigation*, 16 *J.L. & ECON.* 11, 29 (1973) (describing the existence of norms that call for the keeping of promises).

tion for the emergence of norms that require cooperation for mutual gain lies in the field of game theory in general and in the existence of repeated, or iterated, Prisoners' Dilemma games among people.²²

A Prisoners' Dilemma emerges when two people are in a situation in which they have private incentives to do something that is not in the best interests of both people.²³ The classic illustration of the Prisoners' Dilemma involves the situation in which two people are accused of a crime such as armed robbery.²⁴ For our purposes, a variant on the underlying fact pattern of the classic Prisoners' Dilemma presented by David Hume and elaborated on by Kenneth Shepsle and Mark Bonchek²⁵ provides a more useful example. The story involves two farmers who have land that borders on a common marsh. Both farmers would benefit from the draining of the marsh, because drain-

²² ELLICKSON, *supra* note 3, at 156-66.

²³ For a further description of the Prisoners' Dilemma, see KENNETH A. SHEPSLE & MARK S. BONCHEK, *ANALYZING POLITICS: RATIONALITY, BEHAVIOR, AND INSTITUTIONS* 201-19 (1997).

²⁴ The prosecutor does not have enough evidence to convict either suspect without a confession from one of them, but there is enough evidence to convict both of gun possession. Under these circumstances, the prosecutor's best strategy is to separate the prisoners and place them both in a dilemma (the Prisoners' Dilemma) by offering them each a deal with a particular set of characteristics. Specifically, the prosecutor will tell each prisoner that if she confesses and agrees to testify against the other prisoner, she may receive a very light sentence of three months. However, if she does not confess (or "defect" from the point of view of the other prisoner), and the other prisoner confesses, she will receive a stiff sentence of nine years. If both prisoners continue to cooperate with each other and refuse to make a deal with the prosecutor, each will receive a sentence on the gun possession charge of one year. However, if, under interrogation, both prisoners strike a bargain with the prosecutor and defect from their plan of cooperating with each other, each will receive a sentence for armed robbery and weapons possession of four years.

In graphic form the matrix of payoffs looks like this:

		Prisoner B	
		do not confess	confess
Prisoner A	do not confess	A:1yr/B:1yr	A:9yrs/B:3mos
	confess	A:3mos/B:9yrs	A:4yrs/B:4yrs

The point of the Prisoners' Dilemma is that by isolating the two prisoners, the prosecutor can set up a situation where it is in the best interests of both Prisoner A and Prisoner B to defect from their plan of mutual cooperation, *even though following a strategy of cooperation clearly maximizes the aggregate welfare of A and B*. By cooperating and not confessing, A and B each receive one year in prison or two years of total prison time for the two of them. This is clearly superior, both to the eight years they will receive in aggregate if they both confess (and each receives four years), and also to the nine years and three months they will receive if one refuses to deal with the prosecutor (and receives nine years), while the other talks to the prosecutor (and receives three months).

Nonetheless, the Prisoners' Dilemma suggests that both A and B will confess to the prosecutor if they are not sure that their counterpart will remain silent. This is because confessing to the prosecutor is the only way to avoid the worst possible outcome (nine years in prison) and to have a chance of receiving the best possible outcome (three months in prison). But, of course, A and B each have strong incentives to develop norms that will insure that the other will cooperate and refuse to talk if the two are caught.

²⁵ See SHEPSLE & BONCHEK, *supra* note 23, at 201-04.

ing the marsh would destroy the resident mosquito population. But, of course, any funds one farmer expends to drain the marsh will benefit the other farmer, so each has some incentive to sit back and hope the other farmer will do it.

Each farmer stands to receive units of value, called "utiles," from the draining of the pond.²⁶ As Shepsle and Bonchek present the situation:

Suppose each of Hume's farmers valued the drained marsh at 2 utiles. If either were to take the project on by himself, the cost to him . . . would be 3 utiles. Thus, if there were only one farmer available to take on the task, then it certainly would not be worth his while. Suppose, however, that if each farmer worked 'cooperatively' with the other, then it would cost each only 1 utile. In this case each farmer would enjoy 2 utiles worth of drained marsh at a cost of but a single utile—a pretty good deal. Still, though, the best deal of all would be for the marsh to be drained entirely by the other farmer.²⁷

As in the classic Prisoners' Dilemma, the best outcome for both farmers collectively is to cooperate by draining the pond, while the worst outcome is to do nothing. The payoff matrix for the two farmers (measured in utiles) is depicted below:

		<i>Farmer B</i>	
		Cooperate (drain marsh)	Do Not Cooperate (do not drain marsh)
<i>Farmer A</i>	Cooperate (drain marsh)	A:1/B:1	A:1/B:2
	Do Not Cooperate (do not drain marsh)	A:2/B:1	A:0/B:0

By cooperating to drain the marsh, each farmer profits by one net utile.²⁸ By refusing to cooperate, each farmer has no profit and no loss. If a farmer drains the marsh, and the other does not give assistance, the farmer performing the draining suffers a net loss of one utile, while the farmer who does nothing gains by two net utiles.

One of the most interesting features of the game theory literature is the observation that if the farmers have a series of repeated dealings with one another, they will have a strong incentive to cooperate. Where the game is iterative, the farmers will cooperate. Shepsle and Bonchek put it nicely:

²⁶ *Id.* at 202.

²⁷ *Id.*

²⁸ Each farmer has a net increase of one utile because she receives two utiles from the draining of the marsh, but loses one utile as the cost of draining. *See id.* at 202.

Most societies, however, including the one consisting of Hume's two farmers, are more enduring. They do not usually materialize for that one opportunity. . . . Rather, this week it's the marsh that needs draining, next week it's the common fence between the farmers' fields that needs patching, the week after there is the two-man job of replacing a roof on one farmer's barn, and the week after that it's the other farmer's pond that needs to be sealed. In short, societies consist of a series of repeated (or even continuous) encounters, not one-shot plays of a game.²⁹

Robert Axelrod observed that a very likely strategy for a person involved in a repeated game is what he called a *tit-for-tat* strategy, in which the person will cooperate the first time she deals with someone else.³⁰ In subsequent interactions, she will refuse to cooperate only if her counter-party did not reciprocate in the cooperative effort.³¹

The point of the simple game theory presented here is that rational self-interest leads to cooperative behavior under a variety of conditions that are likely to exist in the real world.³² Building on the idea that iterative, or repeat-play, Prisoners' Dilemmas provide incentives for cooperation for mutual gain, Ellickson has developed a hypothesis about the conditions under which welfare-maximizing norms will emerge.³³ Professor Ellickson cautions that societally advantageous norms may not develop outside of closely knit social groups.³⁴ A group must be closely knit in order for welfare-maximizing norms to develop because group members must have "information about norms and violations and also the power and enforcement opportunities needed to establish norms" in order to create sufficient incentives to cooperate.³⁵

There are three problems with this analysis. First, it is not clear from Professor Ellickson's analysis what elements cause a group to be closely knit. The analysis is vague and circular. It is, as Professor Ellickson himself observes, "unavoidabl[y]" vague because "social environments are too rich to be described in terms of a few quantifiable variables."³⁶ Further, it is circular because a group is closely knit when "the information pertinent to informal control circulates easily among

²⁹ SHEPSLE & BONCHEK, *supra* note 23, at 207.

³⁰ ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* 31-33 (1984).

³¹ *See id.*

³² For a thoughtful analysis of incentives resulting from repeated transactions in the business context, see Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643, 1657-77 (1996).

³³ ELLICKSON, *supra* note 3, at 167-83.

³⁴ *Id.* at 173, 177-78.

³⁵ *Id.* at 177.

³⁶ *Id.* at 178.

them,"³⁷ while when information circulates easily among people in a group, that group is closely knit.

A second, and more serious, problem with Professor Ellickson's analysis is that it ignores the strong incentives parties have to reveal information about themselves to others and to make informational inferences to others. To return to David Hume's example of the farmers and the marsh, even if the two farmers are not members of the same close-knit group, once the farmers see that the marsh is not being drained, each has an incentive to point out to the other that she would gain from mutual cooperation. Even though each party has an incentive to understate the value she places on dredging the marsh, if one party does not fully cooperate, Robert Axelrod's *tit-for-tat* strategy³⁸ is applicable to impose sanctions on the other party. Moreover, if the parties are involved in a series of repeated transactions, their incentives to lie to one another about the value they place on various projects will diminish.

In other words, it is the iterated nature of the relationship, rather than the closely knit nature of the parties, that leads to cooperation. Of course, it may seem that closely knit groups cooperate better, but this is likely due to the fact that, by definition, closely knit groups have more interaction with one another. It is these repeated interactions, not the closely knit nature of the groups, that lead to cooperation. Put another way, all closely knit groups are iterative, but not all iterative relationships are among members of closely knit groups. Cooperation in closely knit groups is not the result of the cohesiveness of the group, but is instead merely a consequence of repeated interactions.

The above discussion suggests a third problem with Professor Ellickson's analysis. He fails to consider what might cause a group to become closely knit. Game theory suggests that people will form closely knit groups when they have an incentive. They will have such an incentive when they have a pattern of repeated dealings that allows them to reveal information about themselves in order to avoid entering into a pattern of escalating sanctions (*tit-for-tat* behavior) that will make both parties worse off. In other words, there is no reason why unrelated entities cannot simply decide to become closely knit when it is in their interest. One observes this pattern of behavior among neighbors. Two people who are not closely knit recognize immediately that becoming neighbors places them in a pattern of repeated dealings. They begin to cooperate. They become closely knit by an act of will.

³⁷ *Id.* at 177-78.

³⁸ See *supra* note 30 and accompanying text.

Robert Putnam's recent analysis of social interactions and civic traditions among a variety of regions in Italy shows that trust (what he calls "civic community") can develop even in fairly large communities.³⁹ Consistent with the evolutionary analysis, people in successful societies teach their children to be cooperative in general. They do not teach their children to cooperate only with members of their tribe.

Perhaps more importantly, Professor Ellickson's argument that closely knit groups are more likely to generate welfare-maximizing norms gives rise to empirical predictions and, thus, can be tested. "The [Ellickson] hypothesis that close-knit groups generate norms that maximize the objective welfare of group members"⁴⁰ implies that more closely knit societies should have more welfare-maximizing norms than do loosely knit societies. It also implies that closely knit societies, because they have more welfare-maximizing norms, should do better than more diverse societies. While it is somewhat difficult to test this hypothesis because of the paucity of truly diverse societies, even a cursory glance at the United States—the world's most diverse society and its most successful economy—casts some doubt on Professor Ellickson's idea that only closely knit groups are likely to develop welfare-maximizing norms.

II

THE SUPPLY AND DEMAND OF LEGAL RULES

One can unpack Professor Ellickson's important contribution to the literature on the spontaneous creation of law into four major points. First, he points out that academics have overemphasized the importance of formal legal rules to the detriment of spontaneously-generated norms. In a wide variety of contexts, law is not necessary, either to maintain social order or to promote human flourishing.⁴¹

Second, he observes that the norms that are generated spontaneously in a wide variety of settings are generally welfare-enhancing; they systematically improve the overall well-being of the members of the societies that embrace them. There is little to no evidence of welfare-reducing norms.⁴²

Third, Professor Ellickson observes that there are a variety of formal and informal sanctions that exist outside of the formality of law which serve to control participant conduct.⁴³ A pattern of gradual es-

³⁹ ROBERT D. PUTNAM, *MAKING DEMOCRACY WORK: CIVIC TRADITIONS IN MODERN ITALY* 15 (1993).

⁴⁰ ELLICKSON, *supra* note 3, at 267.

⁴¹ *Id.* at 126-27.

⁴² *Id.* at 267-70.

⁴³ *Id.* at 211-24.

calation of force from gossip to rebuke to mild force to strong force exists in a stunningly wide variety of social control systems, from the lobstermen of Maine⁴⁴ to the cattlemen of Shasta County, California.⁴⁵

Finally, as discussed above, Professor Ellickson suggests that his theory about norms may be limited to closely-knit groups. For the reasons catalogued previously, groups generally, and not just closely knit groups, develop norms of social control. Put another way, the critical element in the analysis is the pattern of repeated dealings among people, not the fact that they are closely-knit. The patterns of repeated dealings among people in the same profession, or living in the same area, or dealing with the same problems, cause them to become closely knit when it is in their interest.

This analysis raises the question of why we need legal rules if norms do such a good job maximizing group welfare. Professor Ellickson himself gives three reasons for preferring law to norms, at least in certain circumstances.⁴⁶ First, Professor Ellickson asserts that spontaneously-generated, welfare-maximizing norms may not do an adequate job of serving the ends of corrective or distributive justice.⁴⁷ Second, Professor Ellickson worries that certain norms that increase welfare within a group may harm people outside the group.⁴⁸ Finally, he is concerned that law is needed to establish the set of foundational entitlements within a particular society.⁴⁹

Robert Cooter, in his discussion of the "jurisprudence of social norms,"⁵⁰ suggests other reasons for the state's role in the enforcement of norms. Because the state enforces the norm through impartial court judgment, Professor Cooter asserts that state enforcement is more "certain" than private efforts to coerce behavior.⁵¹ Similarly, since the state can utilize its "monopoly on official use of force," state enforcement is more "secure."⁵² Perhaps most importantly, state enforcement can reduce private enforcement costs, thus "pulling in" more private enforcement. The threat of public enforcement may cause people to conform to norms, fearing that private individuals will

⁴⁴ See JAMES M. ACHESON, *THE LOBSTER GANGS OF MAINE* 74 (1988).

⁴⁵ See ELLICKSON, *supra* note 3, at 40-64.

⁴⁶ *Id.* at 283-84.

⁴⁷ *Id.*

⁴⁸ *Id.* at 284.

⁴⁹ *Id.*

⁵⁰ Robert D. Cooter, *Law From Order*, in *A NOT-SO-DISMAL SCIENCE: A BROADER BRIGHTER APPROACH TO ECONOMIES AND SOCIETIES* (J. Mancur Olson & S. Kahkonen eds., forthcoming 1998) (manuscript at 38, on file with author).

⁵¹ *Id.* (manuscript at 39). For Professor Cooter's recommendation for norm enforcement through the courts, see Cooter, *supra* note 32, at 1695.

⁵² Cooter, *supra* note 50 (manuscript at 39).

seek to enforce the state-supported norm.⁵³ Although state enforcement must conform to the pre-existing social norms, "state enforcement of social norms can increase private cooperation and production."⁵⁴

While these normative observations are useful in that they suggest some reasons why legal rules should exist in a perfect, platonic world, they provide little explanation for why legal rules actually exist as a positive matter. Drawing on the lessons of public choice analysis, I argue in this part of the Article that the legal rules we actually observe are not necessarily the same as the legal rules that we might want or need.

Public choice, or the economic theory of regulation, focuses on the similarities between politics and markets.⁵⁵ The political world is modeled as a brokerage system, in which politicians survive and flourish in a competitive political environment by maximizing the political support they receive. Interest groups tend to dominate the political process. Such groups form in order to demand legislation from politicians who serve as brokers between the legislation suppliers (taxpayers) and the interest group coalitions who demand legislative favors. These groups are those whose costs of organizing are less than the value of the benefits they receive from politicians, who provide benefits in the form of favorable legislation, paid for by groups that are not as well organized. As Robert Tollison has observed,

[T]he supply of legislation is an inverse demand curve. Those who "supply" wealth transfers are individuals who do not find it cost effective to resist having their wealth taken away. In other words, it costs them more than one dollar to resist having one dollar taken away. This concept of a supply curve of legislation or regulation suggests that the costs of political activity to some individuals exceed the potential gains (or avoided losses). The supply of legislation is, therefore, grounded in the unorganized or relatively less-organized members of society.⁵⁶

In other words, legal rules exist, even where they are unnecessary and inefficient, because well-organized interest groups demand them from politicians. That is, people with similar interests, including business interests, are likely to have patterns of repeated dealings. As Pro-

⁵³ *Id.*

⁵⁴ *Id.* (manuscript at 43). Professor Cooter elaborates on his assertion that state enforcement increases efficiency in his article describing the "market modernization of law." Robert D. Cooter, *The Theory of Market Modernization of Law*, 16 INT'L REV. L. & ECON. 141 (1996).

⁵⁵ See ROBERT E. McCORMICK & ROBERT D. TOLLISON, POLITICIANS, LEGISLATION AND THE ECONOMY: AN INQUIRY INTO THE INTEREST-GROUP THEORY OF GOVERNMENT 7-12 (1981).

⁵⁶ Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 343 (1988) (footnote omitted).

fessor Ellickson's work suggests, these repeated dealings cause people to come together to work out arrangements that will increase their joint welfare. One way that people can maximize their joint welfare is to galvanize into an interest group coalition that lobbies Congress for wealth transfers.

A good example of this process at work concerns the interaction of the rules of the Securities and Exchange Commission and the New York Stock Exchange. The New York Stock Exchange (NYSE) is a private, for-profit organization that serves as a forum for people who wish to buy and sell securities. The NYSE's success—indeed its survival in the face of constantly increasing competition from rival trading forums—depends on its ability to attract companies to list their shares on the Exchange, which in turn depends on investors' willingness to engage in transactions on the NYSE. Consequently, the NYSE has a strong incentive to develop rules that protect investors. For this reason, even prior to the passage of the securities laws, NYSE member firms (and also firms belonging to certain other stock exchanges) "had to submit balance sheets and income statements to the Exchange" and subject themselves to audits by independent accountants.⁵⁷

As a result of this analysis, one might wonder why Congress passed the mandatory disclosure laws in 1933 and 1934, which basically codified the pre-existing rules of conduct applied to NYSE member firms. George Benston made this point and an additional point:

One could also argue that the disclosure policy followed by corporations in the absence of legislation is in the best interests of their stockholders. If management believed that the marginal revenue to the stockholders as a group from disclosure would exceed the marginal cost of preparing and supplying the information, they would disclose their financial and other data.⁵⁸

In other words, the practical effect of the securities laws was to extend to unlisted firms the disclosure requirements, which organized

⁵⁷ George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132, 133 (1973).

⁵⁸ *Id.* at 133-34. Professor Benston goes on to describe the costs and benefits as follows:

The marginal revenue might include the savings to stockholders of not having to gather the data privately, the reduced cost of capital to the firm if prospective stockholders' uncertainty about the firm were reduced, improvement in the marketability of the firms' shares if investors desired financial information, etc. The marginal costs of disclosure might include the cost of preparing and distributing the statements, the costs incurred in informing competitors, suppliers, customers, and government officials, and the cost of misinforming stockholders when accounting statements report economic events incorrectly or inadequately (as when all research and development and advertising expenditures are charged to expense currently).

Id. at 134.

exchanges, such as the NYSE, already imposed on member firms. These unlisted firms tended to be smaller, and for them, unlike for larger firms, a cost-benefit calculation of the kind Professor Benston described would likely result in a rational decision not to disclose the kind of information that the SEC required because the benefits (in terms of lower borrowing costs) would not be worth the costs.

The new SEC requirements deprived many firms' access to the public capital markets because the costs of going public increased due to the new disclosure burdens. As George Stigler observed, "many more new companies used the market in the 1920's than in the 1950's—from one viewpoint a major effect of the S.E.C. was to exclude new companies."⁵⁹ Holding levels of capital constant, the reduction in competition benefited the larger (more politically powerful) firms that were NYSE members.

What is interesting about the story of the SEC's mandatory disclosure rules is that it shows not only that group norms (here the norms of the NYSE) maximize the joint welfare of group members, but also that extending these rules beyond the relevant group can cause significant harm. Moreover, this anecdote also illustrates the public choice theory prediction that there will be a strong demand for legal rules even where the norms generated by private ordering are producing enviable results.⁶⁰

The above example was not intended to suggest that government action produces all harms and no corresponding benefits. After all, the government-mandated disclosure of information by all firms wishing to make a public offering of securities has benefits. The problem is that the costs probably outweigh the benefits, particularly when one considers that, of the many small companies that lost access to the public capital markets, some might have been wildly successful. Nor was the point of the above example that the net costs of all government programs outweigh the net benefits. This is clearly not the case. Rather, the point is that government action involves costs as well as benefits, and that, due to the interest-group nature of the political process, the costs often outweigh the benefits.

However, it is still important to stress that the benefits of some government programs outweigh the costs. For example, government programs that protect property rights,⁶¹ or that invigorate informal control so that people can obtain order without law,⁶² or that produce

⁵⁹ George J. Stigler, *Public Regulation of the Securities Market*, 37 J. Bus. 117, 122 (1964).

⁶⁰ For an excellent description of the institution of strong legal rules in the anti-discrimination context, where private norms would suffice largely on their own, see Robert Cooter, *Market Affirmative Action*, 31 SAN DIEGO L. REV. 133 (1994).

⁶¹ See McCORMICK & TOLLISON, *supra* note 55, at 4.

⁶² See ELLICKSON, *supra* note 3, at 284-86.

public goods under certain limited conditions,⁶³ all suggest a useful role for government. The legislature produces bad laws to appease interest-group coalitions, which trade political support for favorable legislation. The legislature produces good laws for the same reason—sometimes the laws interest-group coalitions demand happen to coincide with the public interest. Law coincides with the public interest where the law that produces the greatest political support for legislators also produces the greatest welfare for society.

Law will also tend to coincide more with the public interest where there are close substitutes for existing rulers:

The ruler always has rivals: competing states, or potential rulers within his own state. . . . Where there are no close substitutes, an existing ruler will be characterized as a despot, a dictator, or an absolute monarch. The closer the substitutes, the fewer degrees of freedom the ruler possesses, and the greater the percentage of incremental income that will be retained by the constituents.⁶⁴

Similarly, where the information and transaction costs of displacing incumbent leaders is low, as in multi-party democracies with strong protections for freedom of the press and low information costs of displacing existing rulers, the economy will tend to grow faster than where despotic leadership and few civil liberties exist.⁶⁵

III

THE SUBJECTIVE INDETERMINACY OF LEGAL RULES

An implication of the above analysis is that politicians, bureaucrats, and interest groups have a strong incentive to disguise their rent-seeking activities.⁶⁶ Interest groups are only able to use the government to obtain wealth transfers from society as a whole because the information and transaction costs to private citizens of discovering and eliminating rent-seeking by interest groups are prohibitively expensive. Put another way, people suffer from the collective action problems of rational ignorance and free-riding.

⁶³ It is wrong to assert, as Pigou did, that government intervention is warranted to cure market failure. A.C. PIGOU, *THE ECONOMICS OF WELFARE* (1932). Rather, government intervention is warranted only where the benefits outweigh the costs, taking into account the possibility of using nongovernmental alternatives. In situations where private arrangements are likely to fail, and where the supposed "beneficiaries" of the relevant legislation can monitor at low cost the performance of governmental actors, there may be a case for governmental action.

⁶⁴ Douglass C. North, *A Framework for Analyzing the State in Economic History*, 16 *EXPLORATIONS ECON. HIST.* 249, 255 (1979).

⁶⁵ See Thomas R. Lansner, *Out of Africa*, *WALL ST. J.*, Dec. 10, 1996, at A22; Enrico Colombatto & Jonathan Macey, *Information and Transaction Costs as the Determinants of Tolerable Growth Levels* (Dec. 1996) (unpublished manuscript, on file with author).

⁶⁶ See FRED S. MCCHESENEY, *MONEY FOR NOTHING* 39 (1997).

Rational ignorance refers to the fact that it simply is not rational for someone to spend more than \$100 in order to discover and stop a piece of legislation that is only going to impose a cost of \$90 on that person. That is why interest-group oriented wealth transfers tend to involve concentrated benefits and diffuse costs.

Free-riding refers to the fact that, because the rewards of legislation benefiting the general public are spread among everyone in the population, individual members of the public lack sufficient incentives to promote public interest laws because the promoters themselves must absorb all of the promotion costs. Hence the enacted laws will tend to benefit whichever small, cohesive special interest groups lobby most effectively, because such small, cohesive groups can more easily resolve their free-rider problems.⁶⁷ As Richard Posner has observed, "the fewer the prospective beneficiaries of a regulation, the easier it will be for them to coordinate their efforts to obtain the regulation."⁶⁸ For example, milk price supports harm everybody who buys milk. The small, cohesive lobby of milk producers nonetheless is able to obtain these subsidies because the stakes are so small that it is not worth it for individual consumers to complain.⁶⁹

Because politicians must maximize their political support to stay in office, they have an incentive to search for issues in which the winners (special interest groups) are easily identified, while it is difficult to identify the losers (the general polity).⁷⁰ By masking the true purpose of a statute and claiming that it is actually in the public interest, legislators and interest groups lower the costs of passing statutes that transfer wealth to themselves. That is why, whenever a new law is passed, "the question whether the legislative action has a public purpose is always one that the legislature purports to have decided affirmatively."⁷¹

As Mancur Olson has observed, passage of costly legislation to protect the professions by erecting inefficient barriers to entry has been facilitated by the "susceptibility of the public to the assertion that a professional organization . . . ought to be able to determine who is 'qualified' to practice the profession."⁷² And as I have observed in another context:

⁶⁷ See MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES* 18, 41 (1982).

⁶⁸ Richard A. Posner, *Theories of Economic Regulation*, 5 *BELL J. ECON. & MGMT. SCI.* 335, 345 (1974).

⁶⁹ See 7 U.S.C. § 1446(c)-(d) (1994) (authorizing milk price supports).

⁷⁰ See McCORMICK & TOLLISON, *supra* note 55, at 17.

⁷¹ Jerry L. Mashaw, *Constitutional Deregulation: Notes Toward a Public, Public Law*, 54 *TUL. L. REV.* 849, 868 (1980).

⁷² OLSON, *supra* note 67, at 35.

Where it is difficult to discern the nature of the wealth transfer embodied in a particular statute, loss of public support will be a small part of a legislator's cost calculation. Interest groups and politicians have incentives to engage in activities that make it more difficult for the public to discover the special interest group nature of legislation. This often is accomplished by the subterfuge of masking special interest legislation with a public interest facade. To the extent that this can be carried out successfully, the political costs to legislators of enacting special interest legislation will decline.⁷³

The point here, of course, is that it is impossible to rely on a legislature's own pronouncements, either in the text of statutes themselves or in legislative history, in order to differentiate legitimate, public-regarding legislative enactments from illegitimate, amorally redistributive wealth transfers.⁷⁴

Indeed, public choice theory suggests that the legislature itself may not even know the social welfare consequences of the statutes it passes. After all, according to public choice theory, well-organized interest group coalitions influence the political process through campaign contributions, honoraria for speaking engagements, outright bribes, and other forms of political support.⁷⁵ Special-interest groups can influence even the most honest, well-meaning Congressman. Due to the rational interest and free-rider problems, poorly organized members of the general public have limited incentives to inform themselves—and, consequently, their elected officials—of the consequences of most legislation. The same free-rider and rational ignorance problems plague individual congressmen and limit their accumulation of information.

Over a wide range of issues, interest groups can shape the outcomes the legislative process generates simply because they control the flow of information to legislators on particular issues. This control of information, particularly regarding complex issues, enables interest groups to “distort congressmen's thinking on an issue—normally all an interest group needs to achieve its ends.”⁷⁶

In other words, the information and transaction costs involved in obtaining and using information about legislative issues results in the passage of special interest legislation by legislators who really believe they are acting in the public interest. The fact that all legislation, by definition, has some supporters heightens the problem. Preferences

⁷³ Macey, *supra* note 1, at 232 (footnote omitted).

⁷⁴ Judge Posner coined the term “amorally redistributive.” Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263, 268 (1982).

⁷⁵ See Gregg Easterbrook, *What's Wrong With Congress?*, ATLANTIC MONTHLY, Dec. 1984, at 57, 70-72.

⁷⁶ *Id.* at 70.

differ, and even reasonable, well-informed people will disagree over the value of some legal rules.

Moreover, the same organizational advantages that enable interest groups to shape Congress's preferences on issues also enable such groups to shape public opinion through the use of advertising and public relations, and to shape judicial opinion through the use of lawyers.

For all of these reasons, even legitimate legal systems create illegitimate as well as legitimate legal rules. On their face, it is simply impossible to distinguish the legitimate legal rules from the illegitimate ones. Any attempt by judges to do so is likely to result in mistakes of over-inclusiveness and under-inclusiveness. Mistakes of over-inclusiveness occur when judges mistakenly strike down welfare-enhancing statutes. Mistakes of under-inclusiveness occur when judges mistakenly uphold welfare-reducing statutes.

Proponents of judicial activism are simply those who prefer mistakes of judicial over-inclusiveness to mistakes of judicial under-inclusiveness. Proponents of judicial restraint simply prefer mistakes of judicial under-inclusiveness to mistakes of judicial over-inclusiveness.

IV

JUSTIFYING A PREFERENCE FOR PRIVATE ORDERING

The above discussion suggests a strong basis for preferring private ordering in the form of informal social controls developed through norms to formal legal rules, even in legitimate, democratic regimes: private ordering generates substantive legal principles that are superior to those that the state produces.

Generally, private ordering is justified because it provides a more efficient allocation of capital and labor than central planning. The major lesson provided by the collapse of socialism in the former Soviet Union and elsewhere is that, in the information age, socialism cannot generate enough wealth to maintain a sufficient level of political and social support for incumbent politicians.⁷⁷ Moreover, because informal norms generate outcomes that are generally welfare-enhancing, while law *at best* generates outcomes that are mixed (and tend strongly towards the welfare-reducing), informal norms should come with a strong presumption of legitimacy. Formal legal rules are likely to be inefficient at best and amorally redistributive at worst. Thus, under a wide range of circumstances, such as when society is interested in maximizing utilitarian considerations, and when society is interested in resolving standard legal disputes within groups, lawmakers are un-

⁷⁷ See Colombatto & Macey, *supra* note 65, at 20.

likely to improve upon the customary rules the group develops through voluntary, private interaction.⁷⁸

In the wake of Professor Ellickson's analysis, together with the public-choice critique of public law presented here, the only serious objections to the idea that private ordering is superior to public ordering are: (1) private ordering will not give sufficient weight to redistributive concerns, and (2) private ordering will not alter the initial entitlements that people have even though these initial entitlements may be unjust.

In analyzing these objections to the system of private ordering, it is important to realize that the relevant question is *not* whether private ordering achieves what could be regarded as perfectly just redistributive outcomes. Rather, in deciding whether to allocate responsibility for redistribution to private ordering, the relevant question is whether private ordering reaches a result that is superior to the result public ordering reaches.⁷⁹

The answer to this question is by no means clear, but three points are relevant in thinking about the issue. First, just as much legal scholarship tends to overemphasize the role of law⁸⁰ as a substitute for norms *qua* a mechanism of social ordering, so too does legal scholarship systematically tend to underestimate the extent to which the private sector can accomplish wealth redistribution successfully. For example, social-science experimentation shows that people tend to share equally the gross proceeds received in bargaining games.⁸¹ Importantly, people's norms about sharing often cause them to make redistributions where they think that initial distributions of property rights are unfair.⁸² This evidence strongly suggests that private ordering does give weight to redistributive concerns and that private ordering alters the initial entitlements that people have where such initial entitlements are not thought to be just.

Moreover, not only are people charitable, but private efforts to help the neediest in society, in fact, "have been much more successful than the federal government's failed attempt at charity."⁸³ Private charities are far more flexible than public charity, and can therefore tailor their approaches to the individual circumstances of the people they are trying to help in ways that government cannot. Government can demand reciprocal promises from aid recipients where appropriate. The government can terminate benefits after a particular period,

⁷⁸ See ELICKSON, *supra* note 3, at 283.

⁷⁹ Professor Ellickson appears to miss this point. *Id.* at 283-84.

⁸⁰ See *id.* at 280-81.

⁸¹ See Hoffman & Spitzer, *supra* note 14, at 275-84.

⁸² See *id.*

⁸³ MICHAEL TANNER, *THE END OF WELFARE: FIGHTING POVERTY IN THE CIVIL SOCIETY* 134 (1996).

but requirements that people actively search for work are difficult or impossible for the government to monitor. It is even more difficult for the government to monitor requirements that welfare recipients remain in school or seek alcohol or drug counseling as a requirement for obtaining benefits. Conversely, different private charities are bound to offer a variety of approaches to social problems, and can therefore differentiate between the needs of various participants far better than government programs.⁸⁴ Private charities also can have more flexible eligibility criteria, thus making them better able to help those truly in need:

Because eligibility requirements for government welfare programs are arbitrary and cannot be changed to fit individual circumstances, many people in genuine need do not receive assistance, while benefits often go to people who do not really need them. More than 40 percent of all families living below the poverty level receive no government assistance. Yet more than half of the families receiving means-tested benefits are not poor. Thus a student may receive food stamps, while a homeless man with no mailing address goes without. Private charities are not bound by such bureaucratic restrictions.⁸⁵

Finally, private charity is superior to government charity because it is more efficient. Today, less than one-third of every dollar allocated to state and federal welfare programs actually reaches recipients.⁸⁶ Private charities do much better.⁸⁷

Second, it should be emphasized that the public sector has failed to accomplish redistribution. In fact, with the recent efforts to reform health care, recognition has come that the massive welfare state erected in the United States over the past sixty years has made things worse, not better, by creating a huge welfare bureaucracy with a large stake in perpetuating itself,⁸⁸ and by creating programs that provide people with perverse incentives to make under-investments in human capital in order to keep themselves eligible for welfare.⁸⁹ "[T]here are more than 77 overlapping federal anti-poverty programs, including 59 major means-tested programs."⁹⁰ If people became wealthy, these bureaucracies would go out of business. For these reasons, it is

⁸⁴ See *id.* at 135.

⁸⁵ *Id.* at 136.

⁸⁶ See *id.*

⁸⁷ See *id.* at 136-37.

⁸⁸ See, e.g., WILLIAM A. NISKANEN, JR., *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971) (arguing that bureaucrats maximize their budget); GEORGE ROCHE, *AMERICA BY THE THROAT: THE STRANGLEHOLD OF FEDERAL BUREAUCRACY* 18 (1983) (discussing the recent "titanic expansion of bureaucratic power" and its effects); cf. LUDWIG VON MISES, *BUREAUCRACY* 18 (1994) (addressing the implications and consequences of bureaucratization).

⁸⁹ See TANNER, *supra* note 83, at 86-90.

⁹⁰ *Id.* at 62.

not surprising that there is no correlation between the poverty rate and the level of welfare spending: the poverty rate has stayed roughly constant for the past 25 years (in fact, it is slightly higher now than it was in 1965), while welfare spending has increased at an almost constant rate.⁹¹

In sum, we ought not lose the lessons of public choice on those considering the ability of the state to affect redistributive justice. Whatever redistributions take place in the public sector are going to benefit those with the resources and organizational acumen to galvanize themselves into effective political coalitions to lobby for wealth transfers in the name of redistribution. The benefits will flow to narrow special-interest groups and will be paid for by widely diffuse interests that are rationally ignorant about the consequences of the legislation. In other words, "welfare" is likely to benefit the middle-class at the expense of the truly needy. Moreover, because it is so costly to monitor the effects of redistributive programs, such programs are especially likely to become a true playground for rent-seeking. In other words, the public sector's track record in dealing with redistributive issues is very long and extremely undistinguished.

Finally, scholars are increasingly recognizing the extent to which public sector programs crowd out private sector initiatives.⁹² In particular, Michael Taylor has shown that state provision of social insurance displaces rather than supplements private mutual aid, and tends to destroy the altruistic norms that people have developed over very long periods of time.⁹³

V

PROCEDURAL AND STRUCTURAL FILTERS AGAINST ILLEGITIMATE LAWS

The following discussion considers how to move the production of legal rules towards an equilibrium that provides more space for private ordering. While it is impossible to distinguish between legitimate and illegitimate legal rules, it does not automatically follow that nothing can be done to affect the mix of good and bad law in society. Procedural norms and rules of constitutional structure provide a possible basis for the creation and implementation of substantive legal rules that will move the mix of legitimate and illegitimate laws in a socially beneficial direction.

⁹¹ See ROBERT RECTOR & WILLIAM LAUBER, *AMERICA'S FAILED \$5.4 TRILLION WAR ON POVERTY* 92-93 tbl.1 (1995).

⁹² See, e.g., DONALD BLACK, *THE MANNERS AND CUSTOMS OF THE POLICE* 196-99 (1980); P. KROPOTKIN, *MUTUAL AID: A FACTOR OF EVOLUTION* 227-28 (1903); TANNER, *supra* note 83, at 145 n.51; MICHAEL TAYLOR, *ANARCHY AND COOPERATION* 134-40 (1976).

⁹³ TAYLOR, *supra* note 92, at 134-40.

A. Constitutional Rules and the Mix of Good and Bad Law

The above analysis has identified two sources of legal rules. First, in a wide variety of contexts, norms, customs, and patterns of repeated dealings provide a reliable set of welfare-enhancing rules. Second, and less happily, discrete, well-organized interest groups enact laws that transfer wealth to themselves from other less organized groups (including the "general public" broadly construed). Sometimes these special-interest group laws are desirable, but more often they are not. Special interest group legislation is undesirable because

economic actors expend vast amounts of resources to obtain rent-seeking legislation, to comply with it, to avoid having to comply with it, to adjust to it, and to prevent it from being enacted in the first place. All of this activity is dealt with thoroughly—at a descriptive level—in the existing public choice literature. Perhaps it is best summarized by Mancur Olson's description of three implications of the interest group model of political behavior. First, "special interest organizations and collusions reduce efficiency and aggregate income in the societies in which they operate and make political life more divisive." Second, interest group coalitions organized to effect wealth transfers "slow down a society's capacity to adopt new technologies and to reallocate resources in response to changing conditions, and thereby reduce the rate of economic growth." Finally, distributional coalitions increase "the complexity of regulation, the role of government and the complexity of understandings," thereby retarding the social evolution of a society and raising the costs of all forms of economic activity.⁹⁴

However, constitutional laws emanate from a different source than ordinary laws. Constitutional laws, which establish the institutions of government and provide the ground rules for making the other laws that govern society, grow not out of long-term customary dealings, but out of episodic negotiation processes. More importantly, the incentive structure that characterizes ordinary lawmaking is different during times of constitutional creation. This is because rent-seeking is a negative-sum game. People, even those belonging to powerful interest groups, generally lose more than they gain from the rent-seeking activity that characterizes ordinary politics.

A simple example illustrates the point. In times of ordinary politics, it will benefit an interest group to spend \$60 in order to obtain \$100 in wealth transfers. Even in the unlikely event that the group making the \$100 wealth transfer has spent nothing to try to block the wealth transfer, this transfer activity constitutes a negative-sum game.

⁹⁴ Jonathan R. Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 479-80 (1988) (quoting OLSON, *supra* note 67, at 74).

One group has lost \$100 (i.e., the amount of the wealth transfer), and one group has lost \$60 (i.e., the amount spent to obtain the wealth transfer); however, the gains have been only \$100 (i.e., the amount received in the wealth transfer). Under these conditions, both sides can benefit by bargaining to prevent this sort of rent-seeking activity. The rent-seekers have benefited by a total of \$40 (\$100-\$60), and the public has lost a total of \$100. By bargaining *ex ante* to create a set of constitutional rules that constrain rent-seeking, both groups can make themselves better off. The rent-seekers can, for example, receive some amount greater than \$40 but less than \$100 to agree to refrain from rent-seeking. As I have explained in another context:

By agreeing *ex ante* (i.e., at the time of constitutional creation) to constrain rent-seeking, everyone can be made better off, because even those few who expect to be net winners from the wealth transfer game can be induced through side payments to support a constitutional structure that restricts coercive, inefficient wealth transfers. Thus, the interest group dynamic during times of constitutional creation may be completely different than during times of ordinary politics—when wealth transfers dominate the political landscape.⁹⁵

In other words, because special-interest legislation adversely affects the public, it has a strong incentive to devise institutional arrangements—constitutions—that make the passage of such legislation more difficult.

One way to make the passage of interest-group legislation more difficult is to establish several independent branches of government, and to permit each one to block or impede the enactments of other branches. The executive veto and the independent judiciary are both examples of how a constitutional separation of powers impedes the passage of special-interest legislation.⁹⁶

Of course, the separation of powers doctrine also impedes the passage of public-regarding legislation. However, the costs generally are considered to be less than the benefits because, by hypothesis, there will be less opposition to public-interest legislation than to special-interest legislation. Consequently, public-interest legislation will be able to clear the gauntlet of constitutional checks and balances of which the separation of powers is a part.⁹⁷

Moreover, there is the opportunity to create constitutional and procedural rules that protect and foster private ordering. Much of the welfare-enhancing tendencies of private norms will serve the pub-

⁹⁵ *Id.* at 481.

⁹⁶ See THE FEDERALIST NO. 73 (Alexander Hamilton) (describing the value of the executive veto); THE FEDERALIST NO. 78, at 468 (Alexander Hamilton) (The New American Library of World Literature, Inc. 1961) (describing the value of judicial review).

⁹⁷ See, e.g., Macey, *supra* note 1, at 247-50 (discussing ways in which the structure of the Constitution impedes rent-seeking by interest groups).

lic interest. Thus the fact that separation of powers or other checks may somewhat impede the passage of public-regarding legislation is of less consequence. Conversely, the private sector cannot so easily circumvent the barriers to special-interest legislation. Because private groups lack coercive force, they are essentially powerless to transfer wealth when blocked from employing the legislature on their behalf. Rational actors in the private order will enter into only mutually beneficial agreements. Procedural and structural systems, therefore, act as an effective complement to a system with the goal of maximizing private ordering.

B. Procedural Rules and the Mix of Good and Bad Law

An interesting and largely unexplored area in which broadly-held societal norms are closely linked with legal rules is in the area of process. In general, rules of procedure are considered to be arcane and complex, while norms are considered to be accessible and easily summarized. In fact, there is substantial overlap between rules of procedure and generally-accepted norms of conduct.

Basic procedural ideas—of fairness, of treating like cases alike, and of deciding contested issues on the basis of neutral principles—are embraced in school yards as well as in textbooks on procedure. The same holds true even for relatively complex procedural ideas, like the requirement of exhausting internal, procedural remedies before turning to outside legal sources for help. This procedural rule is analogous to the commonplace norm that people should at least try and work out their own problems in private before resorting to other remedies.

Our intuitions about fairness derive from our norms about what is right and wrong, not only substantively, but also as a matter of process. We should view with suspicion those procedural rules that are inconsistent with our basic intuitions about fairness because it is also the case that procedural rules are promulgated in order to tilt the balance of power in law formation towards interest groups.

Similarly, as a matter of process, there is a reasonably strong norm against complexity. Simple rules, all else equal, are considered superior to complex ones. Grant Gilmore captured this sentiment perfectly in his classic book, *The Ages of American Law*: "In Heaven there will be no law, and the lion will lie down with the lamb. . . . In Hell there will be nothing but law, and due process will be meticulously observed."⁹⁸ As Dwight Lee pointed out, erecting a costly procedural infrastructure in order to implement legislation often will have the effect of transforming even the most public-spirited program

⁹⁸ GRANT GILMORE, *THE AGES OF AMERICAN LAW* 111 (1977).

into an interest-group cesspool. Lee used the example of legislation designed to protect the environment:

[A]fter an individual makes a[n] . . . expression of support for environmental protection at the polls, much remains to be done if the environment is to be protected adequately. It is unfortunately costly for an individual to express concern for environmental quality by lobbying for the most efficient environmental protection programs and by monitoring those who implement these programs. Predictably [due to collective action problems] there is little genuine public surveillance of environmental protection programs, and organized groups have significant latitude to influence environmental programs in ways that serve their private interests.⁹⁹

Similarly, McCubbins, Noll, and Weingast maintained that the procedural rules established to implement a particular law will be designed to solve the contracting problem that exists between interest groups and politicians.¹⁰⁰ More precisely, this contracting problem takes the form of a nonsimultaneity of performance problem. The problem is that the politicians and interest groups who create administrative agencies and design administrative procedures are aware that after agencies begin operating, it will be difficult for the creators to monitor the agencies' performance. This occurs because the agency will develop its own agenda, and because the politicians and interest groups themselves may lose power later and therefore be less capable of controlling the bureaucrats within the agencies they have created.

Congress can require agencies to give interest groups and politicians certain procedural and structural advantages in the administrative process. This will ensure that the relevant administrative agencies in charge of implementing these interest-group bargains will observe the terms of the bargain struck with the interest group.¹⁰¹ These rule structures are likely to be exceedingly complex.

CONCLUSION

This Article combines the observation that norms are an important source of legal rules with the normative framework that the public choice literature provides to make some observations about the nature and sources of law. The Article is premised on the assumption that law can serve both as a legitimate source of social ordering, and

⁹⁹ Dwight R. Lee, *Politics, Ideology, and the Power of Public Choice*, 74 VA. L. REV. 191, 196-97 (1988).

¹⁰⁰ Matthew D. McCubbins et al., *Administrative Procedures as Instruments of Political Control*, 3 J.L. ECON. & ORG. 243, 261-63 (1987); Matthew D. McCubbins et al., *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431, 440-44 (1989).

¹⁰¹ See Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 8 J.L. ECON. & ORG. 93 (1992).

as an illegitimate forum for amoral wealth redistribution through the exercise of raw state power.

This Article recognizes the impressive power of private parties to successfully order their own interactions through the creation of informal norms of conduct. It also recognizes that legal rules are the product of a market-based process through which politicians attempt to maximize their aggregate political support by supplying legal rules to interest groups in exchange for such political support. Combining these two observations leads to the following realization: outcomes generated by private ordering do not always serve the interests of the politicians, legislatures, and special-interest groups that are uniquely able to supply the law. Therefore, in order to serve their own interests, these suppliers of the law will sometimes create laws that are not legitimately needed.

Perhaps the most important observation this Article makes concerns the inherent indeterminacy of efforts to categorize legal rules as legitimate or illegitimate. Politicians and interest groups work together to pass laws that are illegitimate, though clouded by the rhetoric of the public interest. Lawmakers will categorize illegitimate legal rules as legitimate in order simultaneously to lower the political costs of their activity, while maximizing the gain available from the rent-seeking of interest groups. Illegitimate rules are even more difficult to discern because opposition to such rules is often not economically rational, while those groups hoping to benefit from such rules have a positive economic incentive to defend such rules to obtain wealth transfers.

Because of the inability to distinguish between legitimate and illegitimate rules, an important role exists for process and structure in any legal system. Process and structure can eliminate some of the opportunities to establish illegitimate rules, lessening the importance of identifying the legitimacy or illegitimacy of existing rules. The goal of those organizing a legal order with procedural rules and structural, or constitutional, rules is to create an initial filter to block the flow of as many attempts at establishing illegitimate rules as possible.

Given that private ordering tends to produce legitimate legal rules, while public ordering produces a mixture of legitimate and illegitimate legal rules that tends towards the production of illegitimate rules, there is a strong argument for a "meta-rule" that creates a strong presumption in favor of private ordering over public ordering.

Despite the seemingly depressing nature of the public choice paradigm, which posits that politicians *must* seek payments in the form of honoraria, campaign contributions, indirect political support, and even outright bribes to survive in a Darwinian political environment, there is still some hope for a process of rule creation that generates

public-regarding law. The impossibility of distinguishing between legitimate and illegitimate legal rules does not mean that we cannot do anything to affect the mix of good and bad law in society. Rather, the constitutional and procedural rules that provide boundaries for the creation and implementation of the substantive legal rules that guide our conduct can critically affect the quality of such substantive rules.