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Spontaneous Order - Always Efficient?

Comment on Patrick Simon's: "Emergence of a European Ius Commune"

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The emergence of Ius Commune is an important aspect of the current discussion on the harmonization of European law. Harmonization of law can for example be achieved by international agreements, community law or national legislation. Ius Commune² is a fourth way to harmonize different law systems. The term describes the common understanding of lawyers up to the 18th century of how to interpret legal rules or terms³. In Europe, it evolved out of the Roman tradition and lasted up to the 18th century. Until then, lawyers and legal scholars were educated according to this tradition and agreed upon how to use judicial terms. Despite this common understanding, legislation developed differently between the regions.

Ius Commune is clearly an example of a spontaneous order. According to Hayek, an order must have three properties to be characterized as spontaneous:

- the actors do not design the order, but allow it to emerge by their activity,
- they act independently without binding agreements,

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² See Kötz 1986, who does not expressly mention community law.

³ Kötz 1986, 13

- and the legal framework that governs their behavior does not determine the choice of actions and the resulting outcome⁴.

David Hume has coined the description of a spontaneous order as a result of human action and not of human design. One of the standard examples is the game of chess: The rules of the game provide a framework, but do not force the players to carry out certain moves or to follow a certain plan. Hence, playing a game of chess within these rules in general creates a spontaneous order.

The paper by Patrick Simon tries to describe the emergence of a modern *Ius Commune* in Europe⁵. In one of his very illustrative examples, Simon explains how a contract between a German and a French partner might lead to a situation in which a German judge has to apply French legal rules. However, this would not be sufficient for an *Ius Commune* to emerge. Simon also points out that the parties are likely to perceive this international adjudication or might adapt their future behavior to the experiences they have made. In later contracts, the parties could pick the most convenient rules from the law systems of the different countries involved⁶. In doing so, the contracting parties would not only adapt to the given set of rules, but also to the different interpretations by judges from different nations.

Later contracts will refer to new combinations of available rules, which again might create new interpretative problems to judges in several countries. This could create a spontaneous order, a modern *Ius Commune*. According to Simon, creative contractual constructions are the driving forces for the evolution of law. He reveals himself to be an evolutionary optimist in the spirit of Hayek⁷.

In addition to this, the author criticizes the current effort to harmonize European law as "attempts to stop competition" between national law systems⁸. However, the author does not seem to condemn harmonization as such, since *Ius Commune* could also lead to a harmonized European

⁴ Hayek 1973, 50

⁵ Page 3

⁶ Page 2

⁷ Page 4; on the term "evolutionary optimist", see Schmidtchen 1994, p. 240 with further references

⁸ Page 5

law. Yet Simon definitely criticizes harmonization by design. From the viewpoint of economic theory, some remarks seem to be adequate:

1) Simon claims that the adaptation of contracting partners to rules and adjudication leads to a competition of national laws⁹. However, if contracting parties simply pick rules, this does not necessarily lead to competition. Competition between national legislators requires an incentive to adapt to the behavior of the contracting parties.

To clarify this first point, allow me to introduce an idea which might sound slightly radical to non-economists. If the nations involved charged a fee for the usage of their legal norms, then it would be in a profit-maximizing legislators' interest to be successful in the market for contract law norms. They would take the contracting parties' behavior into account when planning their supply of norms. This would lead to competition between legislators and is sufficient to describe the development of national legislation as a spontaneous order. Of course, other incentive mechanisms can be thought of as well. Without such a mechanism, the legislators would not have any motivation for adaptation. Hence, the process Simon describes is limited to the emergence of new combinations of contract norms, but the norms themselves will not necessarily change.

2) A second caveat concerns the harmonization of legal systems. The emergence of an *Ius Commune*, as well as centralized design, may lead to a harmonized law system. Yet it requires a welfare analysis to show whether a harmonized law system is efficient or not. For example, the "Theory of Optimum Legal Areas" claims that harmonization as such is not necessarily efficient¹⁰. This theory analyzes legal systems as clubs, taking into account the fact that increasing the number of members in a law system has at least two welfare effects. More members might lead:

- to lower average fixed costs to establish the legal system,

⁹ Page 4

¹⁰ See Schmidt-Trenz/Schmidtchen 1991 and Schmidtchen/Schmidt-Trenz 1993

- but on the other hand to increased enforcement costs¹¹.

These two types of costs depend on the number of members within a legal club and must be added up to derive the total costs. The optimum club size is found where the total cost curve has its minimum. Under certain conditions, this optimum may be smaller than the whole population. In this case, the optimal partition of the whole population into law systems would lead to the existence of several disjoint law enforcement clubs.

The optimal legal clubs would be of equal size if the parameters (such as establishment costs of the legal system) were the same all over the whole population. Optimal clubs of different sizes require that the parameters differ from area to area. Applying Frey and Eichenberger's¹² idea of "Functional Overlapping Competing Jurisdictions", the theory of optimum legal areas might show that, with respect to different legal fields, such as contract law, tax law, or tort law, different overlapping partitions may be efficient.

3) My last remark concerns evolutionary optimism, which claims that spontaneous order is always superior to design. This is definitely inspired by the spirit of Hayek's famous article "The Use of Knowledge in Society"¹³. In this paper, Hayek points out that no social planner can have enough knowledge to achieve results that are superior to spontaneous order. However, is spontaneous order necessarily superior to design?

To examine such a question, an economist should build a positive model on the emergence of spontaneous orders. Hayek's work does not provide a rigorous model. This created a research program for later scholars¹⁴, such as Sugden. He describes the evolution of norms using simple game theory¹⁵. His paradigmatic example is the evolution of conventions at road crossings, see Figure 1.

¹¹ Schmidtchen/Schmidt-Trenz 1993 also point out that the value of the law system may increase with the number of members. Taking such a positive network externality into account would lead to a higher optimal club size.

¹² See Frey/Eichenberger 1997

¹³ Hayek 1945

¹⁴ See Schmidtchen 1994, p. 240

¹⁵ See Sugden 1986

Fig. 1: Road Crossing Game

	II		
I		left	right
left		1	-1
right		-1	1

In this game, the players I and II may independently pick either the rule "left" (i.e., the driver who comes from the left has the priority) or the rule "right", when approaching a road crossing. Failure of coordination leads to an accident (denoted with a payoff of -1 to each player). Successful coordination, on the other hand, avoids accidents (denoted with a payoff of 1). Obviously, this game has two equilibria (shaded in Fig. 1), namely "left, left" and "right, right", which creates a coordination problem. Economic theory is unable to predict how the parties actually will behave. Each of the four possible outcomes is equally likely.

Yet if many repetitions of this game take place, economic theory predicts that the behavior of the two parties tends towards coordination: One of the rules emerges as a stable equilibrium, but it is impossible to predict which one will be the outcome. In this game, it makes no difference to the parties which rule is the actual outcome. Neither "left" nor "right" are superior rules, it's only important to achieve coordination. However, spontaneous coordination imposes costs upon the parties. During the process of adaption, the parties suffer from accidents. Hence, this costly adaption process is inefficient compared to a situation where a designer simply commands the parties to obey one of the rules, say "left". In this case, the parties do not have to bear any adaption costs.

A further inefficiency might arise, if one of the two possible coordination equilibria is superior to the other. Let me introduce a second example, see Figure 2:

Fig. 2: Coordination Game (one inefficient equilibrium)

	II		
I		A	B
		3	0

A	3	0
B	0	1

If this game is played repeatedly, the two players will achieve coordination like in the first game: Either AA is the stable outcome, or BB. As above, economic theory is unable to predict with certainty which outcome will occur. Yet BB is inefficient: Both players would be better off if they reached AA. The inefficient equilibrium might as well emerge as the efficient one. Hence, the spontaneous order does not necessarily lead to the efficient outcome. Social order by design helps the parties to save adaption costs and avoids the inefficient equilibrium.

This quick look into the toolbox of positive game theory allows for a normative result: Spontaneous order is not always superior to an institutional arrangement created by design¹⁶. Of course, these games are examples of very simple problems of social order. Since spontaneous order may lead to inefficiency in these simple problems, this does not exactly justifies a more optimistic prediction with respect to more complex problems, such as the creation of complete legal systems¹⁷. On the other hand, the design of a complex system requires knowledge and competency no central planner is likely to have. How to solve this dilemma?

Buchanan rejected the idea that Hayek was naive in his evolutionary optimism¹⁸: "Surely Hayek must acknowledge that the rules that emerge (those that need not be 'constructed') ...may themselves be inefficient." Hayek did see this problem and favored selective intervention to cope with the problem of ineffcient spontaneous order. Let me cite from the first volume of "Law, Legislation, and Liberty"¹⁹: The superiority of emerged law

"(...) does not mean that in other respects such law may not develop in very undesirable directions, and that when this happens, correction by deliberate legislation may be the only practicable way out."

¹⁶ However, this must not be misunderstood as a call for governmental action, since governmental failure also has to be taken into account.

¹⁷ In Law and Economics literature of the last 20 years, an interesting discusion took place on the question of whether Common Law is efficient; see Rubin 1977

¹⁸ Buchanan 1977

¹⁹ Hayek 1973, 88

To put it briefly, Hayek would have had no difficulty in accepting a designed order for problems like the coordination games introduced above. In simple examples like these, design is obviously superior to spontaneous order, since it avoids inefficient equilibria and adaption costs. Concerning complex problems, however, the Hayekian claim seems to hold that spontaneous order is superior to design. In these cases, selective intervention can be justified to correct inefficient developments.

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