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To my parents

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Contents

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Introduction: Law and Collective Action

A married woman who is pregnant asks a court to order a blood test of the alleged father (not her husband) for the purpose of establishing his paternity. The court rejects the woman's motion, relying on the common law presumption of the legitimacy of a child whose mother is married. The court says that the presumption reduces the chance that a child will be stigmatized as illegitimate. The implication is that it is better to spare a child the stigma of illegitimacy than allow him to learn the identity of his biological father.[1]

Police warn local merchants that a certain individual has been arrested for shoplifting, though was never prosecuted. A school warns a potential employer that one of its teachers has sexually harassed a student, though this teacher was not disciplined, dismissed, or fired. The transmission of accurate information surely benefits the merchants and the potential employer of the teacher, but it also may stigmatize. Does this possibility trigger the requirement of due process?[2]

A tugboat operator fails to equip its tugboats with working radios, so the tugboats do not receive weather reports that might have enabled them to avoid a storm that damages customers' goods. The tugboat operator argues that because there was no custom in the tugboat industry to use radios, it should not be held negligent. The court holds that custom is no defense.[3] But why not? Are customary business practices likely to be inferior to those dictated by courts?

A wife and a husband obtain a divorce in civil court. The husband and wife's religious congregation recognizes divorces only if the husband gives his con-

sent, and would ostracize the wife if she remarried in the absence of a religiously sanctioned divorce. The wife submits to a one-sided distribution of assets because the husband threatens to withhold his consent to a religious divorce. Later she asks a civil court to void the contract on the ground that she signed it under duress.[4] If the court grants her request, what effect would her victory have on the cohesiveness of the congregation?

A frequently offered justification for *Brown v. Board of Education*[5] is that even if appropriate separate facilities for blacks were supplied by states, a policy of separating blacks and whites is unconstitutional because it stigmatizes blacks.

A court prohibits a local government from constructing a Christmas tree or crèche on public land. The project offends many people, but it does not hurt them, while it pleases many more people. People are offended by countless projects, from sex education to gun control, but offense of this sort is rarely a decisive factor in the evaluation of such projects. What is different about religious symbolism?

Every day courts must evaluate the stigmatizing effect of an action, the conformity of behavior with social norms, the meaning of symbols, and the consequences of ostracism. Is the stigmatizing of AIDS patients, or illegitimate children, or recipients of welfare, a simple injury like a poke in the eye, or does it enhance social norms that contribute to public order? When businesses follow customary practices rather than deviating, should we assume that the customs reflect the march of progress or the stampeding of sheep? When the government engages in symbolic behavior, like the construction of idols, or restricts symbolic behavior, like the desecration of flags, can it be the case that there is nothing substantive at stake? Can legal intervention eliminate stigmas, change customs and social norms, transform the meaning of symbols—or are these social facts unyielding in the face of self-conscious attempts at reform?

That these things do matter in law and politics cannot be denied. Symbolism and stigma play a role in every major piece of legislation. Flag desecration bills are designed to rebut the symbolism of destroying flags. Affirmative action enhances the stigma of belonging to a minority, according to its opponents, or weakens that stigma, according to its defenders. Modern social welfare and bankruptcy legislation was intended to eliminate the stigma against people who are poor and cannot pay their debts, and against aliens and illegitimate children, yet earlier versions of this legislation were intended to strengthen the stigma. Expungement laws, which erase criminal convictions from offenders' records, reduce the stigma of the ex-convict. And debates over issues as diverse as the sale of organs, surrogate motherhood, the

legalization of prostitution, cost-benefit analysis, and pornography invariably raise questions about the symbolism of the practice in question and the use of law to control it.

In a world with no law and rudimentary government, order of some sort would exist. So much is clear from anthropological studies. The order would appear as routine compliance with social norms and the collective infliction of sanctions on those who violate them, including stigmatization of the deviant and ostracism of the incorrigible. People would make symbolic commitments to the community in order to avoid suspicions about their loyalty. Also, people would cooperate frequently. They would keep and rely on promises, refrain from injuring their neighbors, contribute effort to public-spirited projects, make gifts to the poor, render assistance to those in danger, and join marches and rallies. But it is also the case that people would sometimes breach promises and cause injury. They would discriminate against people who, through no fault of their own, have become walking symbols of practices that a group rejects. They would have disputes, sometimes violent disputes. Feuds would arise and might never end. The community might split into factions. The order, with all its benefits, would come at a cost. Robust in times of peace, it would reveal its precariousness at moments of crisis.

Now superimpose a powerful and benevolent government with the ability to make and enforce laws. Could the government selectively intervene among the continuing nonlegal forms of order, choosing to transform those that were undesirable while maintaining those that were good? Could it tinker with the incentives along the edges, using taxes, subsidies, and sanctions to eliminate, say, the feuds and the acts of discrimination, without interfering with neighborly kindliness and trust? Or would the sheer complexity of social organization overwhelm such efforts?

Turning from positive to normative, how should legislatures and courts deal with phenomena like stigma and ostracism, social norms, reputation, symbolism, and the numerous other sources of order that exist outside the laws of the state? Should we assume that these phenomena are desirable and should be respected or enhanced, or that they are pathological, and should be deterred? Can we specify conditions under which the state should intervene? Can we evaluate different kinds of intervention according to the likelihood that they will enhance desirable forms of nonlegal cooperation and subvert undesirable forms?

These questions are old, and they have occupied the best minds working in many academic disciplines. But they are largely ignored by mainstream legal scholars writing about how law affects behavior, and even more so by scholars writing about the appropriate direction for legal reform.

This book is about the relationship between law and what I will inelegantly

call "nonlegal mechanisms of cooperation." It is motivated by a lacuna in legal theory, and particularly law and economics, on which I draw. The positive branch of law and economics assumes that the individual goes about satisfying his preferences, subject to a budget constraint, but unaffected by the attitudes of others. Preferences may be egoistic or altruistic or both, but nothing, other than the state, prevents individuals from preying on each other when it serves their interests. A person will steal, or drive carelessly, or murder, or lie, unless the state erects a deterrent in the form of laws against theft, negligence, murder, and fraud. This description of the world is partly true, but mostly false. Most people refrain most of the time from antisocial behavior even when the law is absent or has no force. They conform to social norms. The question left unanswered by law and economics is why people conform to social norms. Without an answer to that question, one cannot understand the effect of laws on people's behavior.

The normative branch of law and economics and most other mainstream normative legal theories treat the government as an exogenous force that intervenes to deter socially costly but privately beneficial behavior or, put differently, to solve collective action problems that arise among citizens. Environmental law, for example, is explained and justified as a deterrent to the private incentive to pollute. Clean air, water, and soil are the collective goods that would result from wise environmental laws. Bankruptcy law preserves the value of assets against the uncoordinated efforts by creditors to enforce their claims. The law of intellectual property enables inventors and authors to recoup the cost of their investments when otherwise imitators would deplete the value of original work. Contract law provides security against broken promises, and tort law protects people from interference with their use of property. But these explanations, while useful and interesting, are not complete. The law is always imposed against a background stream of nonlegal regulation—enforced by gossip, disapproval, ostracism, and violence—which itself produces important collective goods. The system of nonlegal cooperation is always in some ways superior and in other ways inferior to the legal solution, and legal intervention will undermine or enhance the background norms of nonlegal cooperation in complex ways. The desirability of a proposed legal rule, then, does not depend only on the existence of a collective action problem on the one hand, and competently operated legal institutions on the other hand. It also depends on the way nonlegal systems always already address that collective action problem and the extent to which legal intervention would interfere with those nonlegal systems.

In making these claims, this book follows a tradition of work that criticizes legal scholarship for focusing too much on the state, for simplifying the relationship between citizens and the government, and for analyzing simple prob-

lems to the exclusion of important and interesting ones. Ellickson (1991) is the most recent and influential representative of this tradition, but the discontent that motivated his work can also be found as far back as the 1960s (Macaulay 1963), and even farther back, in the writings of the legal realists (Llewellyn 1931). The influence of this tradition, however, has been limited by an important failure. This is the failure of the critics to supply a useful analytic framework as an alternative to the methodologies they criticize. Partly because of this failure, the influence of this tradition, when not muted, has not always been positive. Influenced in a vague way by the critics, scholars now use the concept of the "social norm" in a profligate and inconsistent way. Scholars need a methodology that enables a systematic analysis of the relationship between the law and nonlegal mechanisms of cooperation.

This book proposes such a methodology. Part One of the book develops a general model of nonlegal cooperation. The model, which is described in Chapter 2, is a signaling game in which people engage in behavioral regularities in order to show that they are desirable partners in cooperative endeavors. Defection in cooperative endeavors is deterred by fear of reputational injury, but the signaling behavior independently gives rise to forms of collective action that can be of great significance. People who care about future payoffs not only resist the temptation to cheat in a relationship; they signal their ability to resist the temptation to cheat by conforming to styles of dress, speech, conduct, and discrimination. The resulting behavioral regularities, which I describe as "social norms," can vastly enhance or diminish social welfare. The analysis is intended to explain crucial concepts that are neglected or misused in law and economics, including the concepts of trust, status, group solidarity, community, social norm, and custom, and to evaluate the relationship between these phenomena and the law.

The model is based on work in game theory and economics that spans the last four decades but has only recently entered the mainstream of economics and still has not had much impact on legal theory. Much of this work addresses two problems: how people are able to cooperate in the face of the incentives to free-ride on group endeavors; and why behavior has a sticky, discontinuous, or norm-driven quality when, under standard economic premises, behavior should reflect people's idiosyncratic and (by assumption) continuously distributed preferences. The most useful approaches to these questions have made strong assumptions about the content of people's utility functions, for example, assuming altruism, envy, or a desire to conform (for example, Frank 1988, Akerlof 1984, ch. 8, S. Jones 1984, Bernheim 1994); appealed to historical background and institutional detail (North 1990); relaxed the usual rationality assumptions, relying instead on the importance of learning and imitation (Young 1998b); and placed weight on the effects of in-

formation asymmetries (Spence 1974). In Chapter 3, I explain why I find the last approach to be most useful.

Part Two applies the model to several areas of the law. It begins, in Chapter 4, with the claim that the gift is a fundamental signal. Friends, family members, merchants, politicians, diplomats—all those seeking or participating in reciprocal relationships—give gifts in order to attract new partners and reassure old partners of their continuing commitment. This view contrasts with the conventional view that gift-giving is motivated by altruism, and it sheds light on many puzzles in the legal treatment of gifts and gratuitous promises, such as why gratuitous promises are given less protection than commercial promises.

Another important signal is the wedding vow, but this is only the most conspicuous of the many signals that pass between people who enter and maintain intimate relationships, and between them and their friends, their families, and members of the public. Other signals include the shunning of people who enter non-standard intimate relations, and their children, who used to suffer from the stigma of illegitimacy. Chapter 5 uses the signaling model to discuss family relationships and family law. The signaling model sheds light on such important features as the mandatory structure of marital obligations and the state's reluctance to enforce or interfere with intra-marital agreements.

The wedding vow is an example of a signal that starts off as a form of private behavior but is subsequently institutionalized and regulated by the state. Because signaling is important behavior, the state has powerful incentives to exploit it when it produces benefits, and suppress it when it does not. Another arena in which these incentives are displayed is that of criminal punishment, the subject of Chapter 6. This chapter argues, among other things, that punishments designed to shame criminals are unlikely to produce optimal deterrence, and that they have perverse effects in countries like the United States, where criminal punishments can become badges of status in communities that do not trust the government. The signaling model also reconciles two opposing approaches in criminology, one of which holds that criminal punishments are best understood as prices imposed on criminal behavior, and the other of which holds that people obey the law when they believe that the law is legitimate.

Chapter 7 turns to politics, arguing that certain actions, including self-censorship, respect for the flag, and voting, are ways in which people signal their loyalty to the government or to dominant political groups. This chapter shows how beliefs about the symbolic value of behaviors arise endogenously from a model in which people seek to cooperate for personal gain. This chapter proposes a solution to the "voting paradox"—the paradox that people vote

even though any non-tautologous description of the gains from voting indicates that these gains are less than the costs. Chapter 8 extends this analysis to racial discrimination and nationalism. Racism and nationalism are best modeled not as matters of "taste," as under the standard economic approach, but as attitudes that emerge endogenously in a game in which people signal their loyalty to each other by shunning outsiders. The chapter briefly discusses the merits and disadvantages of affirmative action and anti-discrimination law.

Chapter 9 advances a hypothesis about contract law. This chapter argues that nonlegal mechanisms of cooperation support relationships, both business and personal, which legal intervention can undermine. Contract law does not enhance cooperation by punishing those who break their promises, but supplies a commitment mechanism that allows parties to reduce the payoff from breach by giving each other the power to inflict mutual losses at any time and for any reason. Contract doctrines are best understood as a means of enabling parties to make this commitment only when it serves their interest, and of minimizing the size (within constraints) and the variance of the mutually inflicted losses. The theory justifies the highly formal system of contract law that has long been reviled by legal academics.

Part Three turns from particular areas of the law to general issues of normative legal theory. Chapter 10 discusses law and social norms from the perspective of efficiency, redistribution of wealth, and autonomy. It criticizes the view that social norms are efficient, and argues that social norms are often dysfunctional. But this chapter also criticizes the increasingly influential argument that the government should self-consciously try to change social norms, arguing that powerful social norms constrain government actors and that efforts to change social norms can produce unpredictable norm cascades. Chapter 11 argues that people often engage in "principled" behavior for strategic reasons, and examines the implications of this claim for public policy. Chapter 12 criticizes the view that there has been a decline of community in the United States, and that law or the market interferes with communities.

This book has three goals. One goal is to show the value of concepts from game theory for understanding legal issues. This is not a textbook or a survey, however (compare Baird, Gertner, and Picker 1994); the argument should be taken as illustrative of the usefulness of game theory. A more ambitious goal is to persuade the reader about the usefulness of the game theory model I have constructed for illuminating a variety of legal issues. The third goal is to persuade the reader of several substantive claims about the relationship between legal and nonlegal forms of regulation. These claims are scattered throughout the book, but several themes emerge, and they are worth mentioning here.

The first theme is that social norms are usefully understood as mere behavioral regularities with little independent explanatory power and little exoge-

nous power to influence behavior. They are the labels that we attach to the behavioral regularities that emerge and persist in the absence of organized, conscious direction by individuals. These behavioral regularities result from the interactions of individuals acting in their rational self-interest, broadly understood (to include altruism and other forms of interdependent utility), a self-interest that drives people to cooperate across all areas of life. The claim that a social norm caused X or Y is an empty claim. The appropriate claim is "individuals seeking a or b interacted in such a way as to produce behavioral regularities X or Y, regularities that we call 'social norms.'" What distinguishes social norms from other behavioral regularities is that departure from them provokes sanctions, but again the sanctions emerge endogenously as a consequence of people acting in their rational self-interest.

The second theme is that many legal rules are best understood as efforts to harness the independent regulatory power of social norms. These efforts sometimes succeed and sometimes fail; what is important to understand is that social norms are unlikely to change as a result of simple, discrete, low-cost interventions by the government, although proposals along these lines are sometimes found in the literature, and that attempts to intervene are risky, because social norms are complex, poorly understood, and sensitive to factors that are difficult to control. Although social norms are constantly changing as a result of decentralized, undirected interactions, the only way for individuals to self-consciously change them in a direction they seek is to violate them. Not just to violate them, but to violate them in a public and decisive way. Many people engage in this highly risky norm entrepreneurship, but government officials, who do not stand outside the social world, are in a particularly vulnerable position. They are far more likely to conform to social norms than to violate them, so the government will rarely manage radical change of social norms.

The third theme is that many social norms contribute to social welfare, many social norms harm social welfare, and the value of norms is mostly a matter of historical accident. The fourth theme is related to a historical claim that will be familiar to students of sociology, namely, that there has been a gradual displacement of nonlegal regulation by legal regulation. The theme is that this displacement occurred in part because legislatures and courts sought to eliminate the pathologies produced by social norms, not because the social norms reflected values or interests that they do not share. The fifth theme is that this displacement should not be deplored, as is currently fashionable, but celebrated.

PART ONE

Models of Nonlegal Collective Action

2

A Model of Cooperation and the Production of Social Norms

Suppose that a firm seeks an employee for a one-year term, and anticipates that the employee will receive training for the first six months and use his skills to generate profits for the firm during the last six months. During the period of training, the firm will suffer a net loss that it hopes to recover during the period of work. The firm's problem is that if it pays the worker a monthly wage, the worker might quit just when the training is completed, and take himself and his skills to another firm that is willing to pay the higher wage that can be demanded by a skilled worker. The first firm would then either have to hire another, already trained, worker at that higher wage, or pay the existing worker a premium not to leave, in either case losing the return on its investment. Anticipating this problem, the firm does not hire the worker.

Alternatively, the firm might offer to hire the worker on the condition that he receive his entire compensation at the end of the term. Under this arrangement, the worker would not quit after receiving training but before doing work, because then the firm would refuse to compensate him. But the worker might not agree to this arrangement, because he has daily expenses that must be paid from his salary and, moreover, he does not trust the firm to keep its end of the bargain. Instead, the worker might simply promise not to quit prior to the end of his term. But the firm has no reason to believe that the worker will keep his promise. To be sure, many people are honest and will keep their word, but many people are dishonest or adept at rationalizing their actions. Because the firm does not know whether the worker is honest or not, it declines to hire him. A third alternative is for the worker to sign a contract in which he promises not to quit. But the firm knows that courts usually re-