NORMS AND LAW:
PUTTING THE HORSE BEFORE THE CART

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ABSTRACT

Law and society scholars have long been fascinated with the interplay of formal legal and informal extralegal procedures. Unfortunately, the fascination has been accompanied by imprecision, and scholars have conceptually conflated two very different mechanisms that extralegally resolve disputes. One set of mechanisms might be described as the “shadow of the law,” made famous by seminal works by Professors Stewart Macaulay and Marc Galanter, in which social coercion and custom have force because formal legal rights are credible and reasonably defined. The other set of mechanisms, recently explored by economic historians and legal institutionalists, might be described as “order without law,” borrowing from Professor Robert Ellickson’s famous work.† In this second mechanism, extralegal mechanisms—whether organized shunning, violence, or social disdain—replace legal coercion to bring social order and are an alternative to, not an extension of, formal legal sanctions.

One victim of conflating these mechanisms has been our understanding of industry-wide systems of private law and private adjudication, or private legal systems. Recent examinations of private legal systems have chiefly understood those systems as efforts to economize on litigation and dispute-resolution costs, but private legal systems are better understood as mechanisms that economize on enforcement costs. This is not a small mischaracterization. Instead, it reveals a deep misunderstanding of when and why private enforcement systems arise in a modern economy.

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This Essay provides a taxonomy for the various mechanisms of private ordering. These assorted mechanisms, despite their important differences, have been conflated in large part because there has been a poor understanding of the particular institutional efficiencies and costs of the alternative systems. Specifically, enforcement costs have often been inadequately distinguished from procedural or dispute-resolution costs, and this imprecision has produced theories that inaccurately predict when private ordering will thrive and when the costs of private ordering overwhelm corresponding efficiencies. The implications for institutional theory are significant, as confusion in the literature has led to overappreciation of private ordering, underappreciation of social institutions, and Panglossian attitudes toward both lawlessness and legal development.

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INTRODUCTION

Among the most salient features of modern courts are that they are expensive, slow, and inaccurate. Parties to a contract unsurprisingly anticipate many of these shortcomings and write contracts that can reduce the costs, delays, and mistakes that are often associated with enforcing agreements in court. Common strategies are to write contracts with detailed substantive provisions, choice-of-law clauses, and—especially—arbitration clauses.

Of course, even detailed contracts are costly and cumbersome to enforce, and parties frequently seek nonlegal mechanisms to enforce their agreements. Professor Stuart Macaulay is credited with triggering a renaissance of scholarly inquiry when he reported that businesspeople try to enforce agreements without resorting to legal
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cion. 2 Although the observation seems self-evident—perhaps only in retrospect—it marked the start of a growing scholarly fascination with the world of extralegal enforcement: law and society scholars inquired into the social structures that induced contractual compliance, 3 law and economics scholars examined the extralegal institutions that maintained economic governance, 4 and legal historians investigated how commercial agreements were sustained in premodern times in the absence of court ordering. 5

Among the most important strands of scholarship on extralegal enforcement have been inquiries, most famously by Professor Lisa Bernstein, into comprehensive private arbitration systems, or private legal systems. 6 This research primarily consists of case studies of industry groups in which a community of merchants, under the auspices of a trade association, require commercial dealings to conform to standard contracts and trade practices, agree to resolve all disputes through private industry arbitration, and appoint well-respected fellow merchants to serve as arbitrators. Merchants who fail to comply with arbitration decisions are expelled from the trade association and are targeted with economic sanctions, including monetary judgments and the foreclosing of commercial opportunities, and frequently with noneconomic social sanctions as well. 7

Unfortunately, scholarship of industry-wide arbitration systems has suffered from a lack of conceptual clarity. On one hand, this scholarship focuses on the substantive rules in private legal systems and contributes to doctrinal debates in contract law by observing that the tailored rules create administrative efficiencies in resolving disputes. 8 On the other hand, this scholarship also emphasizes the role

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2. Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 AM. SOC. REV. 55, 61 (1963) ("Disputes are frequently settled without reference to the contract or potential or actual legal sanctions.").
3. See, e.g., Marcel Fafchamps, The Enforcement of Commercial Contracts in Ghana, 24 WORLD DEV. 427, 441 (1996) (discussing the fishmonger women of Accra who punish bad payers by screaming and shouting at them when they enter the market); Marc Galanter, Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law, 19 J. LEGAL PLURALISM 1, 27 (1981) ("[T]he social landscape is covered by layers and centers of indigenous law."); Macaulay, supra note 2, at 64 ("Sellers who do not satisfy their customers become the subject of discussion . . . at country clubs or social gatherings where members of top management meet.").
4. See, e.g., infra notes 27, 67.
5. See, e.g., infra note 10.
6. See infra notes 30, 51, 52.
7. See infra notes 57–58 and accompanying text.
8. See infra notes 59, 61 and accompanying text.
of extralegal sanctions in enforcing agreements, suggesting that extralegal mechanisms create enforcement efficiencies. By focusing on both substantive rules and enforcement efficiencies, however, scholarship has conflated two dramatically different economic problems. In fact, economizing on the administrative costs of resolving disputes and economizing on the institutional costs of securing transactions are distinct challenges, and thus instruments that arise to address administrative costs need to be treated separately from those arising to economize on enforcement costs. The presence of both types of instruments in private legal systems suggests that they are responding to separate challenges, and perhaps that one challenge might have more predictive power than the other.

This Essay aims to clarify the economic problems that private legal systems present and to confront the assorted instances in which extralegal mechanisms emerge. Once we understand the instances in which extralegal mechanisms arise, we can formulate better definitions for the assortment of informal mechanisms and recognize their economic significance. Part I reviews the expanding literature on private ordering and identifies two distinct categories of self-enforcement mechanisms that by-and-large have been conflated: one category includes mechanisms in which private ordering operates within the “shadow of the law” and includes formal and informal arbitration arrangements that, despite appearing private, nonetheless rely on state coercion; a second category includes mechanisms that utilize nonstate coercive instruments to secure contracts privately, thus securing “order without law.” Part II highlights important differences between these categories and identifies their distinct features, and Part III then explains why private legal systems belong in the second category and why scholars have mistakenly conflated them with arbitration systems. Part IV then addresses the problems in conventional theory—and the adjudication-determination hypothesis it fosters—that has led to misunderstanding private legal systems, and Part V offers a replacement theory that articulates an enforcement-determination hypothesis. In articulating the economic attributes of alternative enforcement mechanisms, Part V then clarifies that certain private ordering systems arise specifically to address enforcement challenges, and only by understanding these systems as enforcement instruments can we truly understand their economic significance. Central to this alternative approach is the recognition that private

9. See infra notes 27, 30 and accompanying text.
enforcement introduces new costs and therefore presents its own tradeoffs. By overlooking these tradeoffs, current theory overstates the true role of private ordering and overemphasizes the creation of adjudication efficiencies. This overlooking has not been a small error, but instead reveals a deep misunderstanding of when and why private ordering arises in the modern economy. The resulting theoretical confusion has led to overappreciation of private ordering, underappreciation for social institutions, and Panglossian attitudes toward both lawlessness and legal development.

I. THE MANY FACES OF PRIVATE LAW

Perhaps the most efficacious feature of state-sponsored courts is their availability, within jurisdictional limits, to all commercial parties. Institutional economists and economic historians credit this very feature—the ability to enforce impersonal exchange—for state-sponsored courts' central role in propelling the economic progress of nations. In other words, state-sponsored courts' ability to enforce agreements between strangers has been credited with enabling economic activity that had difficulty thriving in premodern societies.

Despite this very attractive economic feature, state-sponsored courts also impose significant costs on those who use them—time-consuming procedures, expensive lawyers, delayed resolutions, and difficult-to-predict outcomes. Consequently, parties in a dispute use a panoply of mechanisms to avoid the courtroom. This Part identifies two prominent species of extralegal mechanisms—those operating in

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10. See, e.g., Avner Greif, *The Birth of Impersonal Exchange: The Community Responsibility System and Impartial Justice*, 20 J. ECON. PERSP. 221, 222 (2006); Avner Greif, *Institutions and Impersonal Exchange: The European Experience* 1 (Ctr. on Democracy, Dev., & the Rule of Law, Working Paper No. 14, 2004). It is hard to overemphasize the significance of state institutions that enable exchange. No less than Nobel laureate Douglass North has advanced the strong claim that “the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World.” DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 54 (1990). The world has by-and-large listened to North’s admonition, as international agencies and external donors have invested heavily to promote the rule of law and law reform in many developing countries. See Thomas Carothers, *The Rule of Law Revival*, FOREIGN AFF. Mar.–Apr. 1998, at 95, 103–04 (discussing Western development efforts designed to effectuate rule-of-law reform).

the “shadow of the law” and those that create “order without law”—that parties use to resolve disputes.

A. Shadow of the Law

One category of mechanisms might be described as settling disputes within the “shadow” of the law, a metaphor first coined by Professor Martin Shapiro when he observed a lack of delineation between courts and other systems of adjudication.\(^\text{12}\) Although Professor Shapiro used the term to emphasize that the law’s shadow was distorted from law itself, the metaphor has come to represent the broad space in which parties understand the possibility of legal coercion. Professor Galanter, criticizing the legal academy’s preoccupation with “legal centralism,”\(^\text{13}\) argued that the law’s primary impact on human behavior is through its casting of a shadow.\(^\text{14}\) Thus, Professor Galanter argued, the “principal contribution of courts to dispute resolution is providing a background of norms and procedures against which negotiations and regulation in both private and governmental settings take place.”\(^\text{15}\)

Under Professor Galanter’s view of the law’s shadow, parties have a reasonably accurate understanding of their legal rights—specifically, the rights that a state-sponsored court will enforce with the state’s coercive powers—and will manage their transactions and disputes accordingly. Professor Macaulay’s early observation that businesspeople will seek to avoid litigation, particularly if less expensive alternatives are available, is best understood as parties maximizing within the law’s shadow.\(^\text{16}\) Professors Robert Mnookin and Lewis Kornhauser modeled and explored the parameters of the


\(^{13}\) Professor Galanter’s criticism of “legal centralism,” a label he borrowed from Professor John Griffiths, targeted a “state-centered view of legal phenomena” in which scholars tend to discuss only those legal instruments found in public courts, to the exclusion of the broad array of private enforcement mechanisms. Galanter, supra note 3, at 1 n.1. The onslaught of scholarship exploring private ordering and private legal systems might convince Professor Galanter to temper his criticism.

\(^{14}\) Id. at 24.

\(^{15}\) Id. at 19.

\(^{16}\) See Macaulay, supra note 2, at 62 (“The legal position of the parties can influence negotiations even though legal rights or litigation are never mentioned in their discussions . . . .”).
law’s shadow in their seminal analysis of divorce settlements. Moreover, the logic extends far beyond conduct that arises within a transactional dispute. The law’s shadow and its articulation of legal entitlements reduce uncertainty and establish a well-understood foundation from which parties pursue cooperation. Professors George Priest and Benjamin Klein’s economic analysis of how parties settle disputes falls squarely within the understanding of how the law’s shadow encourages private ordering within public legal constraints, and the logic of the law’s shadow extends to all sorts of cooperative interactions, including inducing precautionary behavior by would-be tortfeasors and deterring property-rights violations from would-be trespassers. These related theories illustrate that once legal entitlements are clearly defined, parties can economize on litigation costs and reach agreements through Coasean bargaining. So long as the law’s shadow is well defined, parties can engage in mutually valuable conduct without assuming the costs inherent in state-made legal procedures.

The growing and elaborate world of arbitration also falls neatly within Professor Galanter’s view of the law’s shadow. Parties enter into agreements with the confidence that those agreements are enforceable by state-sponsored courts. Parties similarly understand the default rules in state-made contract and procedural law, and they use arbitration clauses and other contract mechanisms to superimpose alternative rules and procedures that better meet their collective needs. These privately crafted substantive rules are credible because they too are products of a legally enforceable contract, and a court will enforce arbitration clauses at least as aggressively as—and probably more aggressively than—any other legal entitlement. Thus,


18. See George L. Priest & Benjamin Klein, The Selection of Disputes for Litigation, 13 J. LEGAL STUD. 1, 4 (1984) (“This paper presents a model of the litigation process that clarifies the relationship between the set of disputes settled and the set litigated.”).


20. The Supreme Court has accumulated a rich history of aggressively and enthusiastically enforcing the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1–16, 201–208 (2006), which establishes “a liberal federal policy favoring arbitration agreements,” Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983); see also CompuCredit Corp. v. Greenwood, 132 S. Ct. 665, 670–71 (2012) (discussing several cases in which the Court found that the FAA overrode other statutory provisions). Recently, the Supreme Court’s enthusiasm
arbitration might be considered a formalization of the informal mechanisms Professor Macaulay observed that are built atop court-enforced entitlements.

B. Order Without Law

A second mechanism could be described as “order without law,” borrowing from Professor Robert Ellickson’s famous work.21 Unlike conduct within the law’s shadow, which builds upon legal defaults and relies on state-sponsored coercion, this mechanism involves a much more categorical rejection of state law and state institutions. In Professor Ellickson’s study, Shasta County ranchers (in contrast to what the Coase theorem would predict)22 rejected the county’s substantive property law and in its place articulated alternative substantive rules.23 To enforce these alternative rules, ranchers established an informal network of gossip and social sanctions, so violators of the community’s norms and customs suffered from scorn and exclusion.24 Central to Professor Ellickson’s order-without-law framework are substantive rules and extralegal enforcement mechanisms that are wholly outside the parameters of the state. His book earns its title because neither state law nor the law’s shadow plays a role in securing social order.25 Order and enforcement of community norms arise entirely from indigenous community institutions.

Self-enforcement systems that rely on indigenous institutions have recently attracted enormous attention from legal scholars of all sorts, and although some have speculated that these methods arise from internal notions of justice and innate motivations of guilt or

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21. ELLICKSON, supra note 1.

22. Id. at 3–4 (“Shasta County Neighbors, it turns out, do not behave as Coase portrays them as behaving in the Farmer-Rancher Parable. Neighbors in fact are strongly inclined to cooperate, but they achieve cooperative outcomes not by bargaining from legally established entitlements, as the parable supposes, but rather by developing and enforcing adaptive norms of neighborliness that trump formal legal entitlements.”).

23. See id. at 231–32 (describing specific Shasta County norms for settling disputes and sanctioning undesirable behavior).

24. Id. at 232–33.

25. To the contrary, the state would only enforce its own substantive law, not the ranchers’ alternative. See id. at 42–48.
magnanimity, the economic logic might simply follow from Machiavelli: “[P]eople cannot make themselves secure except by being powerful.” In order-without-law systems, extralegal mechanisms—whether organized shunning, social disdain, or violence—replace state-sponsored legal coercion to bring about social order and are an alternative to, not an extension of, formal legal sanctions. Thus, this second mechanism is practically a conceptual opposite of arbitration. Even though both traditional arbitration and extralegal methods constitute efforts to avoid state-sponsored courts, the former relies on state-sponsored coercion whereas the latter is a rejection of it and relies instead on nonstate coercion. Social sanctions play the role of the marshal, and custom or social norms define the entitlements and constraints that guide parties’ conduct.

Order-without-law enforcement relies on a diversity of instruments. For example, many merchant communities in early commercial societies that predated modern state institutions and state-enforced contract law used private reputational enforcement to secure transactions. Several merchant communities or merchant fairs—including famously the Champagne Fairs—used law merchants to adjudicate disputes, and commerce was foreclosed to any merchant with an unsatisfied judgment against him. Thus, rulings from law merchants initiated group boycotts that penalized merchants who had been found to breach their contractual obligations. Similar group sanctions are used in modern-day communities in less-developed


nations where contract law and independent judiciaries are not yet reliable. For example, Ghanaian and Vietnamese merchant communities, who do not have access to reliable state-sponsored courts, instead spread reputational information among themselves, such that any merchant with a checkered history is foreclosed from future commerce. Many such tight-knit communities, in addition to coordinating sanctions that impose economic harm, also inflict noneconomic punishments, including social shunning and reducing social status. Illegal transactions offer a third example of extralegal sanctions. For example, the mafia and other criminal networks resort to self-enforcement because their illegal transactions are unenforceable in state-sponsored courts. The colorful world of pirates, whether viewed as illegal economic conduct or as prelegal commerce, illustrates that self-enforcement mechanisms can fit into several of these categories.

The common feature linking these disparate enforcement systems is their reliance on private, nonstate sanctions to discipline individuals. Many of these mechanisms emerged when reliable state-sponsored contract enforcement was unavailable. The law merchant, for example, constructed premodern commercial networks before the

29. See, e.g., Fafchamps, supra note 3, at 442–43 (discussing the limited role of legal institutions in enforcing contracts between Ghanaian firms); John McMillan & Christopher Woodruff, Dispute Prevention Without Courts in Vietnam, 15 J.L. ECON. & ORG. 637, 640–41 (1999) (describing the use of reputation mechanisms and private ordering to enforce contracts between Vietnamese businesspeople); Christopher Woodruff, Contract Enforcement and Trade Liberalization in Mexico’s Footwear Industry, 26 WORLD DEV. 979, 986–88 (1998) (tracing the evolution of private contract enforcement in the Mexican footwear industry as trade barriers were liberalized).


31. See, e.g., Curtis J. Milhaupt & Mark D. West, The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime, 67 U. CHI. L. REV. 41, 43 (2000) (arguing that organized crime provides a “response to inefficiencies in the property rights and enforcement framework supplied by the state”); see also Richman, supra note 30, at 414 (“Jewish diamond merchants have employed their community institutions to profit from illegal goods.”).

行政机构现代政府的可用性，尽管加纳的公共机构发展滞后。这些商人群体表明了组织商业交易的可能性，而无需州政府支持，并揭示了祖先商业社会的见解，以及现代法庭的实用性。大多数学者将这些执法系统描述为先例法订单，这些订单在可靠的公共秩序出现时，当法律制度得以形成时，很容易被取代。然而，这些系统仍存在于现代经济发展的世界中，是当代商家继续执行交易而无需国家赞助的法院维持秩序的可行策略。

虽然商家可能构建这些非法的执法方法，原因与商家构造仲裁系统或者寻求非诉讼解决方法一致，即避免法庭——它们依赖于完全不同的来源的强迫。对于在法律阴影之下的商家，最终确定交易的可信度在于国家。对于维持秩序而无法律支撑的商家，秩序则依赖于暴力，羞辱等形式的私人强迫。

II. THE VARYING FORMALITY OF INFORMAL ENFORCEMENT

在大多数法律和经济研究中，术语“非正式的执法”用来描述该类非法律、私人的执法系统，典型地表现为无法律支撑的类别。这是一个不好的标签，因为形式性，在法律与经济领域的术语中，是指与非法律执法系统相对的法律执法系统，即虚假的，无法律支撑的。
colloquial sense, varies widely across both order-without-law and shadow-of-the-law mechanisms. Moreover, formality is an important but often misleading dimension of variance. On one hand, mechanisms that vary in their formality exhibit important differences that reflect key elements of their institutional environment. On the other hand, differences in formality obscure key similarities and often reflect merely cosmetic variation.

Degrees of formality across extralegal enforcement mechanisms range from what could be called spontaneous mechanisms to structured, or bureaucratic, mechanisms. Much as Friedrich Hayek credited unregulated markets for providing “spontaneous order,” because no deliberate coordination is required to maintain accurate price mechanisms, spontaneous reputation mechanisms similarly require no deliberate coordination. Shasta County cattle ranchers might be a paradigmatic illustration of spontaneous private enforcement. The ranchers relied only on word of mouth and casual gossip to spread reputational information, never formally established or articulated norms defining unacceptable behavior, and never demanded a collective commitment to inflict a coordinated punishment. Instead, information spread throughout the community without institutional help, and individual ranchers responded to specific conduct according to their personal ethical beliefs and their understanding of customary expectations. Without any centralizing institutions, Shasta County ranchers directed scorn and denied fruitful relationships to individuals who transgressed customary codes of conduct. Spontaneous reputation mechanisms, therefore, are highly informal: community members respond individually and spontaneously, without explicit coordination, yet their collective response to particular conduct inflicts both economic and psychic costs to those who violate established norms.

(contrasting an informal enforcement system of relational contracting with formal legal enforcement mechanisms).

37. F.A. Hayek, The Use of Knowledge in Society, 35 AM. ECON. REV. 519, 519 (1945) (“The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess.”).
38. ELLICKSON, supra note 1, at 123–36.
39. See id. at 52–62.
40. See id. at 232–33.
41. See id.
Alternatively, there is a great deal of highly formal and often legalistic extralegal dispute resolution. The most pervasive instance of formal-yet-alternative dispute resolution is the modern world of arbitration. The American Arbitration Association (AAA), for example, is a leading collection of arbitrators that, for hire, resolve commercial, labor, and other complex disputes. Although advertising their services for “individuals and organizations who wish to resolve conflicts out of court,” AAA arbitrators nonetheless adhere to a large body of complex rules and procedures, including a comprehensive code of ethics and a due-process protocol. The complexity and formality of this world of alternative dispute resolution rivals the formality of modern state-sponsored courts and is a world away from how both Shasta County’s ranchers and Professor Macaulay’s businesspeople resolve disputes.

Similar to many modern arbitration systems, the law merchants’ courts at medieval fairs were formal constructions of private enforcement. Private judges were designated as independent adjudicators of disputes between merchants, and they followed established protocols to acquire information and then issue and disseminate rulings. Although neither the judges nor the fairs had coercive authority to enforce judgments, the judges’ dissemination of their rulings triggered a coordinated boycott among the law merchants that denied business to any wrongdoer. In contrast to Shasta County’s spontaneous enforcement, the law merchants established formal institutions to probe into particular disputes, apply merchant norms in determining wrongdoing, and spread reputational information. And like modern-day professional arbitrators, the


45. See Milgrom et al., supra note 27, at 4 (noting the importance of “legal codes governing commercial transactions and administered by private judges drawn from the commercial ranks”); Sachs, supra note 28, at 747 (“By virtue of their profession, merchants could be judged by the law merchant as opposed to common law . . . .”). Professor Avinash Dixit explains why the private judges would have been incentivized to maintain their own reputations for accuracy and honesty. AVINASH DIXIT, LAWLESSNESS AND ECONOMICS 97–123 (2007).

46. Milgrom et al., supra note 27, at 3.
private judges had structured factfinding proceedings and needed to justify their conclusions.\(^\text{47}\)

Other reputation enforcement mechanisms have varying degrees of formality that might fall between Shasta County’s spontaneity and the law merchants’ formality. During Vietnam’s early stages of economic liberalization, for example, Vietnamese merchants relied on commercial-information networks, families, and common trade connections—a system that could be characterized as moderately formal.\(^\text{48}\) Nineteenth-century traders in Mexican California relied on a similarly semiformal network of abbeys and monasteries as informational conduits to learn and share reputational information.\(^\text{49}\) And Seafax, an internet company that serves wholesalers of caught fish, serves as a highly formal informational instrument within a spontaneous reputation mechanism. The company compiles the payment histories of prospective buyers of fish, along with their credit records and other publicly available financial data, to help sellers decide with whom they will transact.\(^\text{50}\) These information mechanisms are quite formal, but they trigger a spontaneous collective punishment.

In sum, although the collection of private enforcement systems spans time, geography, and culture, two significant dimensions of variation have emerged in the literature. The first concerns the source of coercion that secures transactional compliance, in which some systems rely ultimately on the state whereas others rely on private power. The second is the degree of formality that characterizes the dispute-resolution and adjudicatory mechanisms. The institutional features of these assorted mechanisms of enforcement can thus be summarized in the following schema:

\(^{47}\) See Milgrom et al., supra note 27, at 16 (“[Law Merchants] may wish to maintain their reputation for honesty and diligence in order to keep the business active.”); Sachs, supra note 28, at 765 (“Decisions reached in the courts of other cities or communities could be challenged and even reversed in the fair court.”).

\(^{48}\) See McMillan & Woodruff, supra note 29, at 638 (“Firms often scrutinize prospective trading partners before beginning to transact, checking the firms’ reliability via other firms in the same line of business or familial connections.”).

\(^{49}\) Cf. Clay, supra note 27, at 204 (“The mission priests traded directly with the ships’ captains and supercargoes who brought goods to the coast.”).

\(^{50}\) Seafax Products and Services, SEAFAX, http://www.seafax.com/about/Products (last visited Nov. 2, 2012).
III. PRIVATE LEGAL SYSTEMS—A CONFUSING HYBRID

A particular species of private ordering system that has received significant academic attention is industry-wide arbitration systems that use both privately tailored industry law and privately ordered industry sanctions. In these private legal systems, a particular merchant community—which often comprises an entire industry segment and is frequently organized as a trade association—constructs an elaborate system of law and procedure that is responsible for all disputes within the merchant community. Professor Bernstein is a leader in uncovering such systems, including those supporting the Diamond Dealers Club of New York, the National Grain and Feed Association (NGFA), and the assorted trade associations that govern America’s cotton merchants. Professors John McMillan and Christopher Woodruff uncover similarly organized reputation systems that enforce agreements made by America’s fresh-fish wholesalers and by New York’s dress

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53. Bernstein, supra note 30, at 1724.
manufacturers, and other scholars have brought this analytical lens more recently to studies of kosher certification, food labeling, and eco-friendly accreditation.

A number of common features typify these trade-association-led private legal systems. First, the arbitration systems are highly developed and comprehensive, employing fellow merchants as elected arbitrators, relying on specialized law, and using expedited procedures. These systems resemble the formality of the AAA’s arbitration procedures but invoke privately crafted substantive and procedural rules that are tailored to the needs and common concerns of disputing merchants, such as requiring industry-provided form contracts or delivery of goods by certain times and in certain measurements. Second, these arbitration systems tend to assume exclusive authority over all industry disputes. Not only do all merchants have access to arbitrators to resolve any dispute with a fellow merchant, merchants are also prohibited from seeking redress in alternative venues, including state-sponsored courts. And third, failure to comply with an arbitration ruling leads to expulsion from the trade association. Although expulsion in its own right is not terribly costly, it signals untrustworthiness to other merchants, thereby foreclosing future commerce. In other words, much like the


56. See, e.g., Bernstein, supra note 52, at 1777 (describing the NGFA arbitrators’ hierarchy of authority and noting that NGFA arbitrators consult trade rules and trade practice before the Uniform Commercial Code and other statutes); Bernstein supra note 51, at 122 (discussing trade-specific, formalized rules of offer and acceptance); Bernstein, supra note 30, at 1732 (“The [Memphis Cotton Exchange] decides cases on the basis of the Exchange’s own Trading Rules . . . .”).

57. See, e.g., Bernstein, supra note 52, at 1771–72 (“As a condition of membership in the Association, members must agree to submit all disputes with other members to the Association’s arbitration system.”); Bernstein, supra note 51, at 120 (“Unless the club opts not to hear the case, the member may not seek redress of his grievances in court.”); Bernstein, supra note 30, at 1727 (“Most [shippers’ associations] require members to arbitrate disputes with other members as a condition of membership.”).

58. See, e.g., Bernstein, supra note 52, at 1772 (“A member who refuses to submit to arbitration or fails to comply with an arbitration award rendered against him may . . . be suspended or expelled from the Association.”); Bernstein, supra note 51, at 130 (explaining that
sanctions triggered by a ruling by a private judge in the Champagne Fairs, an adverse arbitration ruling and expulsion from the trade association triggers a coordinated group boycott.

Private legal systems have caused some conceptual confusion that has not only clouded our understanding of different private ordering mechanisms, but has also impeded a precise appreciation of these systems themselves. The source of the confusion is self-evident. On one hand, from appearances, private legal systems primarily look like arbitration arrangements and thus resemble the world of arbitration that operates within Professor Galanter's shadow of legal entitlements. On the other hand, they rely on social sanctions, not legal instruments, to effectuate arbitrators' rulings. At first blush, private legal systems appear to be an engineered synthesis of both arbitration and social sanctions.

Legal scholarship in particular has contributed to the confusion by focusing attention on the adjudication efficiencies generated from industry-tailored law. Scholars observe that specialized substantive rules reduce the complexity and required time to generate rulings, that streamlined procedures reduce the costs of advancing or defending claims, and that expert adjudicators produce more accurate rulings than generalist judges or juries.59 In short, legal enthusiasts proclaim, private legal systems are more efficient, reliable, and accurate.

One cannot blame legal scholars for focusing on the features that are naturally of greatest interest to them. If private legal systems were a Rorschach test, legal scholars—who are deeply familiar with the costs of adjudicating disputes in state-sponsored courts—would remark on the systems’ specialized law and procedures to identify administrative efficiencies. This enthusiasm is not just understandable but, in large part, quite justified. Private legal systems do generate arbitrators sometimes pursue judgment in the rabbinical courts, which have the power to exclude an individual from participating in Jewish community life).

meaningful administrative efficiencies, and there is much to learn from the benefits of industry-wide and industry-made substantive and procedural rules. Appreciation for these systems’ administrative efficiencies has been part of, and has contributed to, what has been called the New Formalism, probably the most significant development in contract scholarship in the past two decades.

But this scholarly enthusiasm has led to a causality error. More than merely admiring the adjudication efficiencies, scholars have argued that merchant communities develop private legal systems specifically to capture these savings. Professor Bernstein, for example, explicitly describes private legal systems as an “opting out” of state-sponsored dispute resolution, suggesting that state-sponsored courts are a viable but merely less preferable venue, and that constructing a private legal system reflects a deliberate choice to capture litigation savings. Scholars of contract law and civil procedure frequently characterize private legal systems with the same language, and as achieving the same purposes, as rudimentary arbitration agreements. They thus view the private enforcement of arbitration rulings as conduct within the shadow of otherwise enforceable law, and they have conceived private legal systems to be close relatives of more typical arbitration systems.

Despite appearances, private legal systems do not arise to economize on transaction costs and thus should not be viewed as a generalizable species of arbitration. To the contrary, they arise out of idiosyncratic circumstances, achieve different efficiencies and objectives, and operate under a different theoretical framework from

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60. See David Charny, The New Formalism in Contract, 66 U. CHI. L. REV. 842, 842 (1999) (“We are now in the midst of a third phase, a phase of ‘anti-antiformalism’ that seeks to discredit and displace Llewellyn’s claim to found commercial law in immanent commercial practice.”). Professor Bernstein’s scholarship has played a leading role in building the New Formalism movement. See, e.g., Bernstein, supra note 52. Two other leaders of New Formalism are Professors Robert Scott and Alan Schwartz. See, e.g., Schwartz & Scott, supra note 59.

61. See Bernstein, supra note 51, at 126 (“[A]rbitration is preferable to litigation because it is cheaper, faster, and subjects the member to [unique] pressures to pay promptly.”).

The defining features of these private legal systems are not, as much of the literature suggests, their rigorous use of arbitrators or their formulation of tailored law. Instead, the key features are how their agreements are enforced and the nature of the coercive mechanisms they employ. Because private legal systems rely on private sanctions and private enforcement, they are more accurately understood as instances of private ordering. They have much more in common with Professor Ellickson’s Shasta County ranchers than they do with arbitrators or other conduct that takes place within the shadow of the law. Accordingly, legal scholarship has overemphasized the role of adjudication efficiencies and has failed to develop a theory that accounts for private legal systems’ other economic attributes. And any such theory would recognize that these other attributes have more predictive power than adjudication efficiencies.

IV. THREE STRIKES FOR THE CURRENT THEORY

Scholarly enthusiasm for adjudication efficiencies—minimizing the costs, time, and errors in producing adjudication rulings—has generated the incorrect conclusion that adjudication efficiencies induce the emergence of private legal systems. This is the *adjudication-determination hypothesis*, in which adjudication efficiencies are the horse that drives the private legal system’s cart of private enforcement. But although specialized procedures tend to emerge alongside private enforcement mechanisms, they neither cause the creation of private enforcement nor drive a departure from state-sponsored courts. Instead, they are merely secondary consequences of what ultimately is an economizing of enforcement costs. Three foundational mistakes in the literature on private legal systems reveal why industry-tailored law and industry-wide arbitration do not lead to private enforcement.

First, the adjudication-determination hypothesis does not explain why private legal systems are relatively few in number. If the motivation behind private legal systems is to generate litigation efficiencies, then it is curious that they are so rare. It is almost beyond doubt that tailored law and streamlined procedures enable private

63. Cf. Charny, supra note 60, at 843 (“[T]rade association formalism . . . does not counsel formalism in commercial law generally; rather, it reflects, and takes advantage of, the idiosyncratic institutional structures of the associations themselves.”).
legal systems to enjoy substantial efficiencies over public courts, but why does economic research overwhelmingly indicate that reliable public courts are central to facilitating economic growth? And why did most historical instances of private ordering dissolve with the emergence of public courts?

Missing from conventional understandings of private legal systems is that, in addition to enjoying meaningful efficiency advantages over public courts, they also impose significant costs that public courts do not. These costs are unrelated to the litigation process, however, and instead involve the institutional efficiencies of enforcing contracts. Because private legal systems rely on sustained reciprocity, they offer credibility only to insiders and thus erect significant entry barriers to outsiders. The balancing of enforcement costs—the benefits of creating transactional security versus the imposition of entry barriers—determines the economic desirability, vis-à-vis alternatives, of private legal systems. It is for this same reason that some early systems of private ordering persisted into the

64. To be clear, Professor Bernstein deserves enormous credit for identifying and articulating many of the administrative efficiencies found in systems of private law. See supra notes 30, 51, 52 and accompanying text; see also Jason Scott Johnson, Should the Law Ignore Commercial Norms?, 99 Mich. L. Rev. 1791, 1810 (2001) (“Bernstein’s study . . . advances our knowledge of private commercial lawmaking institutions . . . .”).

65. See, e.g., NORTH, supra note 10, at 111 (“We have long been aware that the tax structure, regulations, judicial decisions, and statute laws . . . determine specific aspects of economic performance . . . .”); Avner Greif & Eugene Kandel, Contract Enforcement Institutions: Historical Perspective and Current Status in Russia, in ECONOMIC TRANSITION IN EASTERN EUROPE AND RUSSIA: REALITIES OF REFORM 291, 318 (Edward P. Lazear ed., 1995) (“Economic growth in market economies is fundamentally based on the ability to exchange, which is limited by the ability to enforce contracts.”).

66. See AVNER GREIF, INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE 343 (2006) (“In England . . . the state facilitated the replacement of the community responsibility system with one based on individual legal responsibility and the coercive power of the state.”).

modern age, whereas most succumbed to the emergence of reliable state-sponsored courts.\footnote{A popular hypothesis that accompanied examinations of underdeveloped legal systems was that, in fact, relational contracting and private ordering would inevitably succumb to public courts. \textit{See, e.g.}, P.J. FitzGerald, \textit{Salmond on Jurisprudence} § 31 (12th ed. 2006) ("Although custom is an important source of law in early times, its importance continuously diminishes as the legal system grows."); \textit{see also} Robert D. Cooter, \textit{Structural Adjudication and the New Law Merchant: A Model of Decentralized Law}, 14 Int'l Rev. L. & Econ. 215, 216 (1994) ("Many intellectuals believe that centralized law is inevitable, just as they once believed that socialism was inevitable.").}

The adjudication-determination hypothesis’ second fault, following from its first, is exposed by the flexibility of arbitration. If adjudication costs were of primary concern, then industry groups might affix tailored rules and procedures atop state-sponsored enforcement. For example, a merchant community could develop its own specialized legal templates and use state-sponsored courts to enforce arbitration decisions. Through a trade association, the community could require all of its members to use contracts that, should a disagreement arise, compel disputing parties to use a private dispute-resolution forum with preselected arbitrators, industry-tailored law, and strict limitations on costly components of litigation such as discovery. Courts would uphold and enforce any conclusions by the arbitrators, and pursuant to the Federal Arbitration Act\footnote{Federal Arbitration Act, 9 U.S.C. §§ 1–16, 201–208 (2006).} and similar state-law provisions, courts would even stay any parallel litigation before them that is subject to an arbitration agreement.\footnote{\textit{E.g.}, \textit{id.} § 3; \textit{see also} Gillian K. Hadfield, \textit{Privatizing Commercial Law: Lessons from the Middle and the Digital Ages} 7 (Stanford Law Sch., John M. Olin Program in Law & Econ., Working Paper No. 195, 2000), \textit{available at} http://papers.ssrn.com/sol3/papers.cfm?abstract_id=220252 ("‘Private’ arbitration is a creature of contract and so is as much a matter of ‘public’ law as any contract.").}

Consequently, the industry could leave enforcement entirely to state-sponsored courts while maintaining a private legal forum. This hybrid would be the best of both worlds: all the administrative savings from the privately tailored substantive law and procedures, yet no need to rely on reputation mechanisms, nonlegal sanctions, or any other instruments of private enforcement that, necessarily, erect costly entry barriers.

Private legal systems, however, are distinct from typical arbitration precisely because they rest atop private enforcement mechanisms—and, in fact, they tend to prohibit their members from seeking relief from state-sponsored courts, as victors in arbitration are
able to do. Given the costs of employing private enforcement, why would private legal systems also institutionalize costly coordinated punishments rather than piggyback off public courts? Or conversely, why do so many industries rely primarily on standard arbitration in which arbitration rulings are enforceable in state court, yet certain industries operate entirely outside the legal system?

That private legal systems rely only on private enforcement, and are thus distinct from typical arbitration, suggests that something more than administrative savings is at work. Consistent with proponents of the New Formalism, we see a move across all forms of arbitration—and in several areas of state law as well—toward rules and procedures that lead to swift and predictable judgments. But we see significant variation in enforcement, with some parties enforcing arbitration through the courts and others participating in insular merchant communities that reject state-sponsored courts and rely instead on coordinated punishments. Because administrative efficiencies cannot explain this variation, an alternative source of economizing must be at work. All merchant communities that invoke private sanctions use specialized law, yet specialized law is widespread beyond these insular merchant communities. The key to understanding these unusual private legal systems, then, lies much more in the economics of enforcement than in the economics of adjudication.

The adjudication-determination hypothesis’ third error is its presumption that private legal systems require arbitrators and well-

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71. Bernstein suggests that diamond merchants are welcome to seek confirmation of a Diamond Dealers’ Club judgment in state courts, but that such confirmation “is rarely necessary.” Bernstein, supra note 51, at 129–30. I would argue, however, that state-court confirmation would be futile. Instead of state courts serving as a supplemental enforcement mechanism, state-court failures trigger the need for alternative enforcement. See Richman, Antitrust, supra note 67, at 330–34 (“These important limitations on the capabilities of state courts force the diamond industry to depend instead on private mechanisms to enforce contracts.”).

72. See supra note 67 and accompanying text.

73. See, e.g., supra notes 59–63 and accompanying text.

74. See Bernstein, supra note 51, at 115 (“[T]raders . . . have developed an elaborate, internal system of rules, complete with distinctive institutions and sanctions, to handle disputes among industry members.”); Richman, supra note 30, at 397 (“The [Diamond Dealers Club’s] system of arbitration and information exchange thus sets the stage for other family- and community-based institutions to enforce industry’s executory contracts . . . .”)

developed private law. After all, the hypothesis assumes, if private legal systems emerge because of administrative efficiencies, then it would be strange indeed to have a legal system without any legal substance or procedures. It would be like agreeing to arbitration without identifying an arbitrator.

In fact, however, in parts of the diamond industry, disputes are privately resolved without judges or law. Although Professor Bernstein’s famous analysis of the New York Diamond Dealers Club describes a world of arbitration with clear substantive rules and clearly identified arbitrators and procedures, India’s diamond center is very different. Consider the following exchange:

Author: So what happens when merchants have a disagreement?

Merchant: They resolve it. They always want to work things out.

Author: But what happens when they can’t resolve it themselves, when there was a genuine misunderstanding or disagreement that has no easy compromise solution?

Merchant: Then they’ll find a senior, respected person in the industry and that person will resolve it.

Ninety-five percent of the world’s diamonds flow through India’s diamond center. With its epicenter located in Mumbai and its burgeoning cutting and polishing industry in the nearby state of Gujarat, India is an emerging capital of the diamond industry and is gradually overtaking New York and Antwerp in significance. Yet there are no arbitrators and no binding arbitrations. Parties simply resolve disputes on their own and establish their own order without any law.

76. Interview with confidential source in the Diamond District, Mumbai, India (Mar. 13, 2008).

77. See Manjeet Kripalani, Polishing the Diamond Business, BUSINESSWEEK, Sept. 11, 2000 (“De Beers, the longtime monopolist, is finding its cartel usurped by Canada, Russia, and Australia, which want to go directly to diamond-cutting centers without using a middleman—a move that could raise India’s current 55% share of the world diamond industry.”); Nicky Oppenheimer, Diamonds and Dictators, WASH. POST, Dec. 29, 1999, at A27 (stating that more than 700,000 people are employed in the diamond-cutting industry in India). For a general discussion of India’s emergence in the diamond industry, see PIRAMAL, BUSINESS MAHARAJAS 315–62 (1996).

78. For a discussion of how globalization forces are changing the diamond industry and of how Mumbai’s emergence as a diamond center is a quintessential reflection of those forces, see Barak D. Richman, Ethnic Networks, Extra-Legal Certainty and Globalisation: Peering into the Diamond Industry, in CONTRACTUAL CERTAINTY IN INTERNATIONAL TRADE 31 (Volkmar Gessner ed., 2009).
These three problems are enough to discard the adjudication-determination hypothesis. Efficient adjudication procedures and substantive rules cannot drive the emergence of private legal systems. The flexibility of arbitration enables achieving administrative efficiencies without developing private enforcement systems, and diamond centers outside the United States reveal that private enforcement systems thrive without structured arbitration. At the very least, this conclusion should dampen the general enthusiasm for private legal systems. If adjudication efficiencies are not responsible for the emergence and survival of private legal systems, then scholars should be more cautious in endorsing them as a model for arbitration systems.

The heart of the hypothesis’ shortcoming, and the corresponding weakness in the conventional legal-centric theory that undergirds it, is its failure to recognize the particular costs inherent in private legal systems. Legal scholars thus overstate the efficiencies of private legal systems and thus incorrectly overpredict their incidence.

V. PRIVATE LEGAL SYSTEMS, PROPERLY UNDERSTOOD

How should private legal systems be understood vis-à-vis other self-enforcement systems? And what then predicts the emergence of private legal systems in the modern economy?

Whereas current scholarship emphasizes adjudication efficiencies and thus conflates private legal systems with conventional arbitration systems, a proper approach begins by examining the role of enforcement costs through a lens of institutional economics. In short, the adjudication-determination hypothesis should be discarded for the enforcement-determination hypothesis. Focusing on this very different category of efficiency considerations illustrates that private legal systems belong much more squarely in the order-without-law mechanism along with other systems that rest upon coordinated social sanctions or private enforcement methods. Despite appearing like typical arbitration systems, they arise out of rather particular circumstances and economize on what could be called enforcement costs. The enforcement-determination hypothesis suggests that enforcement efficiencies are the horse that drives the emergence of private legal systems, and adjudication efficiencies are largely secondary. This hypothesis means that the schema depicted in Figure 1 is not just an illustration of alternative categories but also a depiction of a causal, sequential model.
What are enforcement costs and how, according to economic logic, do they determine the incidence of private legal systems? A starting point begins with a core principle of institutional economics, which is that all institutional arrangements exhibit certain efficiencies and costs, and articulating those comparative costs and benefits can predict their emergence under different economic circumstances. A comparative assessment of public versus private enforcement requires assessing the institutional capacities of each mechanism.79

The table below summarizes a comparative assessment of enforcement costs associated with the alternative mechanisms.80

Table 1: Public Courts Versus Reputation Mechanisms

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<tr>
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<th>Public Courts</th>
<th>Private Legal Systems</th>
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<tr>
<td>Adjudication Efficiencies</td>
<td>−</td>
<td>+</td>
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<tr>
<td>Nonexclusivity</td>
<td>+</td>
<td>−</td>
</tr>
</tbody>
</table>

The key insight reflected in the table is that both private and public enforcement exhibit comparative efficiencies and costs, relative to one another. Consistent with much of the legal literature, private legal systems do achieve adjudication efficiencies that are unattainable in public courts. As was discussed in Part III, they rest on substantive and procedural rules, allowing for predictable rulings and stark factual determinations that do not require significant litigation costs. They follow expedited procedures that assure prompt judgments. And they rely on arbitrators who are industry insiders and have both expertise and experience closely relevant to the disputes they judge. However expensive, slow, and inaccurate state-sponsored

79. A more complete institutional analysis requires comparing multiple mechanisms, including vertically integrated firms. This analysis would include the paradigmatic make-or-buy question in institutional economics and an assessment of both concerted sanctions and vertical integration as alternative private mechanisms. For a more complete assessment, see Richman, Private Ordering, supra note 67, at 2337–51.

80. For some policy implications of this comparative assessment, see Richman, Antitrust, supra note 67, at 368–72.
courts can be, private legal systems build rules and procedures to be cheaper, faster, and more accurate.

A significant shortcoming of private enforcement, however, is that it can only reach those who subscribe to it—reputation mechanisms can only police those who place value in maintaining a good reputation. Professor Galanter remarked that although “indigenous communities” enjoy powers that are unavailable to public courts, “the indigenous tribunal faces the problem of obtaining leverage over those who are impervious to community opinion, getting them to submit to its jurisdiction or to comply with its decisions.”

Thus, the reach of private law is limited to long-term players who are assured of, and who credibly are committed to pursuing, a long horizon of transactions.

This limitation leads to a critical drawback of private ordering: reputation-based private enforcement erects sizable entry barriers. Because only participating long-term players have incentives to cooperate, newcomers who have not yet established a good reputation are unable to commit credibly to uphold their contractual promises. Thus, Professors John McMillan and Christopher Woodruff noted that “[t]he corollary of ongoing relationships is a reluctance to deal with firms outside the relationship.” Even an honest merchant who has yet to demonstrate a good reputation will not be able to transact business with other merchants.

Entry barriers impose many inefficiencies, especially dynamic inefficiencies, to an economic system. They limit the threat of superior competitors—those with lower costs, superior skill, or new technologies—and shelter inefficient incumbents. The exclusivity of privately ordered reputation mechanisms also sustains economic homogeneity and conformity, precluding entrants with new business models and entrants who might experiment with innovative techniques. Relatedly, an ossified merchant community is more likely to resist value-added competition. Because trade in a private system occurs within a closed community comprised of traders who are linked by channels of information and communication, merchants are well positioned to collude on price or collectively deny competitive entrants access to supply networks and other necessary resources.

82. McMillan & Woodruff, supra note 54, at 2454.
83. Both Professors McMillan and Woodruff and Professor Richard McAdams have observed that relational contracting and closed economic networks can impose noneconomic
These significant dynamic costs are tradeoffs with the also significant benefits of greater transactional security and low-cost adjudication. Recognizing these reciprocal costs of private legal systems helps explain why these systems are not more widespread in the modern economy. Similarly, it explains why the emergence of reliable state-sponsored courts coincided with the waning of relational exchange that relied on private enforcement. Accordingly, enthusiasts of private legal systems should pause and consider these significant drawbacks of reputational enforcement. But perhaps more important, this Essay’s approach illustrates why enforcement costs determine the incidence of private legal systems and thus are the horse that leads the cart.

This Essay’s approach also should bring more clarity to our understanding of private legal systems. Although those systems are often characterized as arbitration systems with specialized law, in reality they are dramatically different from conventional arbitration. Private legal systems do indeed rely on arbitration, and they similarly are credited with developing specialized systems of substantive and procedural law. But both the arbitration and legal qualities of these systems belie the true economic—and often social and historical—forces that spawn their existence and create their efficiencies. They instead emerge only when the benefits of attaining better enforcement outweigh the heavy costs of creating entry barriers. This is a much more balanced and determinative assessment than one involving adjudication costs.

Thus, although Figure 1 depicts a very parsimonious mapping of alternative enforcement regimes, it offers some lasting lessons. First, it separates public from private enforcement, thereby properly distinguishing private legal systems from typical arbitration. Second, it emphasizes that economizing on enforcement costs, not adjudication costs, determines the most efficient enforcement regime.

harms as well, such as bigotry and persistent discrimination. See Richard H. McAdams, Cooperation and Conflict: The Economics of Group Status Production and Race Discrimination, 108 HARV. L. REV. 1003, 1049–53 (1995) (describing the economic forces that led to the development of the Jim Crow South); McMillan & Woodruff, supra note 54, at 2423 (“Private order also can cause or perpetuate racial or gender discrimination.”). Professors Curtis Milhaupt and Mark West and Professor Diego Gambetta also reveal that trust-based exchange and closed ethnic networks can use violence, in addition to reputational mechanisms, to enforce compliance. See DIEGO GAMBETTA, THE SICILIAN MAFIA: THE BUSINESS OF PRIVATE PROTECTION 173 (1993) (“Thieves who do not respect protected customers are punished, at times with extreme violence.”); Milhaupt & West, supra note 31, at 47–48 (discussing the problem of organized crime in high-trust societies like Japan).
for particular merchant transactions. And third, it poses deep challenges to the conventional legal-centric theory that aims to understand commerce through legal rules rather than through the underlying institutions.

CONCLUSION

Although private legal systems have captured the imagination of a wide assortment of scholars and disciplines, that attention has not yet translated into a comprehensive understanding of those systems. One source of confusion has been a preoccupation with administrative costs, which are naturally of primary concern to legal scholars but in fact are a diversion from the underlying economic forces that sustain private enforcement mechanisms. This preoccupation might be another instance of Professor Galanter’s legal centralism, and perhaps the biggest lesson is that even if organizations look and act like courts or arbitrators, they in fact might more closely resemble instruments used in prelegal societies.

At the very least, scholars studying private legal systems should scrutinize enforcement costs more than administrative costs, and they should make greater use of institutional economics than litigation economics. But there might also need to be a wholesale reevaluation of the implications that have emerged from studies of private legal systems. Rather than heralding their efficiencies, there should be greater recognition of their costs; rather than encouraging industries to take up tailored arbitration, there should be greater study of when private legal systems emerge and where they succeed; and rather than treating private legal systems as a squarely legal product, there should be greater adherence to early law and society conclusions, that legal and legal-like processes must be viewed within the underlying social and economic context in which they emerge. The significance of private legal systems is not how they appear but what lies beneath.