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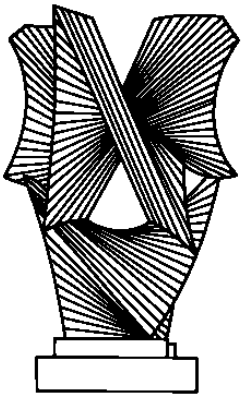

HARMONIZATION, PREFERENCES, AND THE CALCULUS OF CONSENT IN COMMERCIAL AND OTHER LAW

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Harmonization, Preferences, and the Calculus of Consent in Commercial and Other Law

Saul Levmore*

Abstract

The European Union is exploring a move toward harmonization in the form of a common commercial code (CESL), with some mandatory provisions especially with respect to consumer law, but alsoincorporating a large dose of business-to-business law that would be optional at the enterprise, rather than jurisdictional, level. This paper begins with the question of when harmonization is preferable to diversity, and not just with respect to commercial law. It tackles the problem from the perspective of the median voters in jurisdictions, some of which have similar preferences and some not. It introduces the ability of a stable and like-minded group to impose external costs on others, and then also on the ability of like-minded players to benefit by favoring central decisionmaking rather than local authority and local preferences.

1. Introduction

All harmonization is not equal. When it comes to child labor, for example, members of an economic or political union, and even their external critics and competitors, generally agree that constituent states should harmonize their laws. Mere trading partners agree to harmonize their copyright laws. There is less agreement about securities law, and much less about other subjects of domestic regulation, including school curricula, state-supported religions, health care delivery, tort law, subsidy and taxation of the arts, and approval processes for pharmaceuticals. For these subjects, we find variety with respect to policies, statutory frameworks, rules, and enforcement even within "unified" legal systems. Across jurisdictions, only some of these laws seem to converge over time, though there is more harmonization within an economic union than among simple trading partners. One wonders whether the variety illuminates the optimal level of harmonization with respect to commercial law in the European Union.

For the most part, harmonization opportunities come at the expense of variety, in the form of respecting local preferences, or political outcomes. There are many potential

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gains from harmonization, but proponents of harmonization with respect to commercial law across the European Union are likely to stress the potential reduction in transaction costs. Skeptics are likely to be anxious about the process of choosing the focal points around which to harmonize and then also to favor the ongoing competition among jurisdictions that harmonization suppresses. One form of compromise is not to harmonize but to offer an attractive alternative that might appeal to jurisdictions, or even to businesses and individuals, that can then opt in to this alternative set of legal rules– though it must be apparent that member states could simply harmonize around one of the many existing commercial codes. The alternative might be limited to, or more attractive for, cross-border transactions. The Draft Common European Sales Law (CESL) fits this description, even as it incorporates many mandatory terms. It offers an opportunity to think specifically and generally about harmonization.

Part 2 begins quite generally with the relationship between local preferences and harmonization. Part 3 takes a brief detour to include the role of harmonization in promoting union-wide identity. Part 4 takes account of local preferences, and the role of the median voter, in order to understand what might be harmonized. Part 5 introduces the inefficient moves a majority might make because of its ability to impose "external costs." These inefficiencies can illuminate the winners and losers from harmonization. Part 6 builds to a conclusion about the winners and losers from harmonization by developing the notion of an organized subgroup with similar preferences, and contrasting harmonization with spontaneous convergence.

2. Preferences as a source of harmonization or variety

There are two conventional explanations for the failure to respect local preferences where child labor is concerned. The first is that children have little market power, political influence, or representation. One might learn to tolerate or even celebrate diversity, but it is easier to do so where there is real choice. Citizens of Country A might find some of Country B's laws exotic, but that tolerance is often limited to settings where B's citizens could dethrone their ruler if they chose; child labor, torture, serious discrimination, and even capital punishment are quite different. A's citizens might be outraged by B's segregated housing patterns, income inequality, genetically modified crops, consumption of horse meat, immodest fashions, and so forth. With the possible exception of consumer protection, most of commercial law creates less excitement in foreign jurisdictions, so

that it is likely that this explanation of harmonization has little bearing on our subject, except to remind us that it can come from preferences about other people's well-being.

A second explanation is that one's own moral sensibilities with respect to the behavior of others are heightened when competitive advantage is in the air. If a jurisdiction prefers nicer parks, and raises taxes to finance these parks,[1] it recognizes that some businesses may migrate to other jurisdictions, but at least that seems "fair." The parks do not serve the needs of the businesses, and residents must pay for the parks they prefer. In contrast, if a jurisdiction shelters the homeless, its citizens are apt to think that it is wrong for businesses to be able to move away and escape "their share" of this cost. The superior shelters represent an unselfish expenditure, or so it will be thought, and, if mobility is easy, there may be a race to the bottom in which no one can afford to help the homeless even though some prefer to do at the first step. If we combine the two explanations we can say that the objection to local preferences, and the moral case for harmonization, arises either where human rights are concerned or where mobile taxpayers are perceived as evading a responsibility and driving jurisdictions to a lowest common denominator where other-regarding preferences are at issue.

The domestic regulation of child labor might raise the cost of doing business, and this will encourage some businesses to expand or migrate to unregulated jurisdictions. Domestic interests will regard this as a race to the bottom. A jurisdiction might combat some part of this unpleasant competition by regulating consumption rather than production. Its law might simply forbid the consumption of goods made with child labor–or made in jurisdictions with pro-business commercial law–or it might tax such goods to compensate for the advantage that the "inferior" regulatory system bestows on its businesses. A mixed approach could bar domestic production and then ban offending imports. But this strategy suffers from high enforcement costs. The offended jurisdiction requires a good deal of information about production in other countries; in contrast, most domestic regulation succeeds by monitoring a very few manufacturing sites or accepting complaints from whistleblowers, of which there will be many when a popular cause is at issue. Moreover, even when foreign violations can be identified, one must have the ability to block or tax imports. It is not just that international trade agreements may stand in the way, but also that goods can be channeled through third countries or simply sold in

[1] I recognize that a jurisdiction has no preferences, but rather that the people within it do so. The discussion refers to a jurisdiction's sentiments as shorthand for its median voter, its politicians, its intensely concerned and organized constituents, or its constituents' aggregated welfare, as the context requires.

other countries while nonoffending goods are directed to the jurisdiction with the highest standards.

This initial example will seem rather remote from most of commercial law, with regard to which the rhetoric is likely to be about transaction costs rather than morality.[2] Still, preference protection may be more important than transaction costs in terms of motivating harmonization.[3] The example is also unusual, or even misleading, because most strategies for satisfying preferences lead to respect for *disparate* practices, or variety in law or markets, if only to satisfy dissimilar predilections across jurisdictions. Most preferences can be satisfied without insisting that other jurisdictions' practices advance the same preferences as one's own.

An easy example of this sort of variety concerns public support for the arts. A citizen might feel strongly that her government should support ballet companies, rather than have those entities rely entirely on patrons, but it is rare to see political capital expended in order to encourage a foreign jurisdiction to support that art form. Few people object to diversity in arts spending, though they do not go so far as to appreciate the economist's Tieboutian perspective, that they might relocate and sort themselves into jurisdictions that offer the bundle of taxes and goods they prefer. Sorting at this level is

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[2] Harmonization in commercial law is unlikely to be justified on the basis of externalities, though it might be advanced with the claim that nonharmonized rules encourage some leakage and thus devalue a country's unilateral laws. The claim seems weak for commercial law. Similarly, the usual fear of unfair competition from unregulated jurisdictions seems much more robust where preferences are concerned, as discussed in the text, than for commercial law. A claim regarding an economy of scale seems plausible but nothing stops a jurisdiction from allowing its commercial laws to converge with others. Harmonized laws might be a step towards political unification, which brings its own scale economies, but this seems minor in the case of the EU. These features of harmonization reflect the useful and insightful framework, as well as skepticism, advanced in Leebron, "Claims for Harmonization: A Theoretical Framework", (1996) 27 *Canadian Business Law Journal* (1996), 63-107.

A respectable case could be made for the idea that local preferences have so little to do with commercial law (consumer protection aside), that the game must be entirely about principal-agent problems or other reasons why jurisdictions resist the "obvious" gains from harmonization. Carbonara & Parisi, "The Paradox of Legal Harmonization", (2007) *Public Choice* 367. The authors adopt this starting point, and then proceed with the interesting idea that local resistance might be a strategy to get others to absorb the "switching costs." In other words, harmonization offers benefits, and the trick is to incur as little of the costs as possible. To the extent that this is the case, the discussion here adds fuel to the wrong fire.

[3] Gomez & Ganuza, "An Economic Analysis of Harmonization Regimes: Full Harmonization, Minimum Harmonization or Optional Instrument", http://ec.europa.eu/justice/news/consulting_public/0052/contributions/166_en.pdf, sets out clearly the choice between transaction costs saving and local (country level) preferences, along with references to the ongoing debate regarding EU commercial law. The discussion below reflects some of the same thinking about the likely compromises that are made when two or more jurisdictions harmonize their laws.

academic. Moving is costly and even prohibitive for many residents; governments are unable to promise the continued provision of particular goods;[4] and there are too many goods alongside too few jurisdictions that will accept migrants. A modest amount of sorting is the best we can expect.

3. Harmonization and a "preference" for shared identity

Why then does a central government ever support something regarding which there are diverse preferences? First, there may be an interest group, or even a majority, that is well enough organized to defeat local interest groups. The interest group that wants to spread its desire for ballet may find it cheaper to push for central support than to influence ten local governments. Other interest groups can, of course, compete, and when the dust settles it will be impossible for us to judge whether interest-group activity helped reveal intense preferences and achieve a desirable result or, instead, encouraged wasteful rent-seeking or imposed external costs (a topic discussed in Part 5 below) and did not maximize social welfare. Similarly, we might intuit that some interest groups prefer the harmonization of commercial law and others do not, but we are enfeebled when it comes to expressing normative judgments about the results of such battles.

The second, more far-reaching reason for central support is that authorities, or elites, might see such a policy as a useful means of promoting group identity. Thus, the Chinese government based in Beijing supported and pressed Mandarin on the provinces, even though we might guess that local preferences were overwhelmingly inclined to maintain local dialects and not to bear the switching costs. Mandarin became mandatory for some things, and it was to be the language of the future if only because it was imposed on primary schools everywhere, but we can think of it as an "opt-in" choice for many enterprises. Note that most of economic theory conveniently assumes that preferences are given, and the usual paradigm leaves no room for something like "developing a national identity," or otherwise investing in the development of new preferences. A central agency in control of arts funding might be expected to favor touring performers, works that draw on common historical experiences or myths, and other projects that promote a shared national identity. In the case of the European Union, elites may also favor projects and laws that promote a European identity, but they know to minimize coercion. Indeed, the centrally-planned commercial law now ascendant in

[4] There are exceptions. Investment in durable goods, and even capital goods like schools, helps. Famously, the development of an industry with tax revenue implications, like the corporate law industry in Delaware, helps commit to a pattern of laws over the long term.

the EU is full of choice at the enterprise rather than jurisdictional level, and this may be the best tool of national unity that is politically acceptable.

The fact that one interest group promotes harmonization in furtherance of a shared identity does not mean that other groups cannot join in the project but have different motives. Large commercial enterprises might favor the harmonization of commercial law either because of the potential for reducing transaction costs in their far-flung transactions or because they perceive a competitive advantage over modestly sized firms that are comfortable with local laws. An interesting possibility is that risk averse businesses might prefer variety because different laws favor different business strategies or (even) products. Any one business will more likely find a market in which to flourish if there are different markets, and commercial law is part of what makes a market. Disparate businesses will thrive in in different environments, and variety in law makes for different environments. Just as a given business might like free trade, because it opens new markets even as it brings in competitors to the market it already inhabits, so it might like different environments, and thus non-harmonized laws, in these markets. This may be a modest factor compared to the cost of switching (for some businesses) and the cost of interfacing and dealing with several legal systems (for others), but these latter factors are already appreciated as part of the case for and against harmonization. European Union bureaucrats will prefer harmonization for very different reasons, and not only the evolution of a shared identity, including the fact they are likely to be the source of mandatory and other rules. But it bears repeating that wherever harmonization is found, it has the capacity to promote a shared identity.

4. Sorting versus median voters

The most significant cost harmonization is the sacrifice of the welfare gains obtained when mobile citizens sort themselves in a differentiated world. But sorting is not the only way to accommodate disparate preferences. When a decision is made in a constituent jurisdiction it will reflect the political process found there. If we simplify by setting authoritarian governments, powerful bureaucrats, interest groups, and even intense preferences aside, we can settle on the approximation, or ideal, that a jurisdiction's political decisions reflect the preferences of its median voter. Thus, even if citizens are immobile, differentiation can be expected to improve welfare so long as there is some pressure for jurisdictions to respond to or reflect the preferences of its residents. Legal systems are in this way like firms in a market, and variety provides benefits. We should expect (even) similar jurisdictions to have disparate traffic laws, arts subsidies, criminal

laws, farm policies, school curricula, and environmental laws alongside their different cuisines and fashions. With respect to some of these topics, there are right answers, as opposed to mere preferences, and we might expect various processes to lead to convergence on those answers, or best practices. At the same time, many right answers depend at least in part on preferences. Any two populations are likely to have people with different preferences, and it is unlikely that two jurisdictions will have median voters with identical preferences on many issues. In all the areas just listed, there is only a modest inclination (or preference) for imposing preferences on other jurisdictions, and there is benefit in not having foreign preferences imposed on oneself. In one example (traffic laws) there are modest transaction costs to be saved through harmonization and in another (environmental law) there are externalities to be dealt with, but in none of these cases would the argument for harmonization be made as strongly as it is with respect to commercial law.

When two jurisdictions harmonize their (traffic, environmental, or commercial) laws, it is likely that they compromise between the domestic compromises they have already made. We can conveniently imagine that the median voters in the two jurisdictions must meet and agree on a midpoint, or perhaps the "combined" jurisdiction reaches a result that reflects its median voter. As the number of jurisdictions increases, it is theoretically possible to imagine that the losers, which is to say those whose preferences are distant from the median voter's, in many jurisdictions could locate one another and benefit from central decisionmaking by overcoming their respective median voters at that level.[5] Without direct elections for the centralized authorities, however, this is most unlikely.

To be sure, laws are not only about preferences. Many questions of law have right answers or codify best practices, as opposed to median preferences–unless the correct characterization is simply that the median voter prefers the best practice. For example, the speed limit on comparable bridges might be identical in different jurisdictions. But most laws will reflect a mix of superior policies and preferences. Thus, there is no single best set of criminal penalties, because preferences come into play where questions of

[5] In other words, each country in the EU can be thought of as a jurisdiction in which the median voter prevails. When these countries combine and make centralized decisions it is barely possible that the result is not a compromise among the 27 median voters, or a majority of those idealized positions, but rather an aggregation of the losers in many countries who find enough like-minded partners at the federation level. This is, of course, vastly more likely in a federation like the United States where these nonmedian voters can combine to elect a president, or even more so in a federation with frequent plebiscites. A federation dominated and managed by elected representatives of constituent states seems far more likely to reflect the median voters in some of those states.

experimentation, rehabilitation, and expenditures on improving prison conditions are concerned. To be sure, the median voter in a jurisdiction might also have a preference about the desirability of harmonization, and mixed into this preference calculation will be that voter's own projections regarding transaction costs and experimentation, so we might expect some amount of harmonization, or simply convergence, rather than diversity, for this reason alone. It follows that if two jurisdictions have similar populations (in terms of preferences), their respective median voters might not be so far apart in terms of their inclinations. In turn, when transaction costs associated with trade, enforcement, and other matters are added in, preferences regarding the content of laws might indeed converge across these jurisdictions. Even if we could set simply imitation aside, we would expect the laws of two countries in Western Europe to be more similar than one drawn from a South America and the other from a democracy in Southeast Asia.

Prior to enriching the analysis with the concept of external costs, it may be useful to pause and placate the reader who is impatient with this circuitous approach to harmonization of (EU) commercial law, both because commercial law seems especially removed from mere preferences and because the CESL is structured as optional—especially where business-to-business transactions are concerned, and even more so because the choice is at the enterprise rather than jurisdictional level. Even readers who are inclined to agree that a theoretical approach, situating one harmonization question within others, can be profitable, are likely to object that most of commercial law not only reflects right answers regarding transactional efficiency but also deals rather directly with trade among jurisdictions and, therefore, transaction costs more than preferences. The median voter surely wants these costs reduced, the argument goes, and has perhaps been thwarted by local interest groups, including lawyers who invested in learning local codes and who enjoy something of a monopoly if these disparate codes are retained. The benefits from harmonization–as well as the explanation for stasis–might be analogized to those at stake where the metric and imperial measurement systems are concerned.

There are a few responses to this objection. One is that commercial law, especially when mandatory, brings on more conflicts among interest groups, perhaps because some rules impose costs on those parties that do not expect to engage in much cross-jurisdiction trade. A better response is that commercial law is not unmoored from voters' preferences. To begin with, there is the question of consumer protection, where protecting careless or unsophisticated shoppers comes at a cost to all, and thus implicates preferences regarding wealth distribution, paternalism, and the like. It is unsurprising that

this piece of European harmonization receives the most attention.[6] A second, less significant trigger of preferences is the inevitable suppression of local history, language, and culture implicated in all harmonization. A population that values tradition will gain utility from commercial (or any) law that can be traced back to the rules used by its forebears.[7] There is no reason to expect this taste to be similar across populations, especially because some nations prefer to distance themselves from their geographic or genetic ancestors, while others exalt them. Finally, and most significantly, many elements of commercial law mix preferences with right answers. Priorities in bankruptcy, for example, might pit the claims of employees against those of the debtor's tort victims, and various preferences and values will generate an inclination to favor one group over the other. Even the details of a secured transactions regime will bring into play relative tolerance for forcible repossessions and garnished wages, while others will reflect judgments about how much risk consumers should bear in return for lower prices.[8]

5. The calculus of consent and optimal legal areas

The more we think of law as reflecting the preferences of the median voter, the more we need to ask why something is decided by law rather than left to markets (or families or other institutions) in the first place. In median voter terms, we can begin by noting the tyranny of the median voter, and then move to the question of why we cannot increase

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[6] There are principal-agent problems affecting voters and their representatives and also between legislators and "their" regulators. Consumer protection law is likely the area within commercial law where these are most significant, and thus the role of harmonization in advancing the cause of one or the other the greatest. Singer, "Capital Rules: The Domestic Politics of International Regulatory Harmonization", (2004) *International Organization* 531-65, thinks of harmonization as a tool for satisfying domestic political pressures rather than the regulators own preferences.

[7] The role played by culture in creating friction (or noncompliance) for harmonization is discussed in Falkner, Treib, Hartlapp, and Leiber, *Complying with Europe: EU Harmonization and Soft Law in the Member States* (Cambridge, 2005).

[8] Secured Transactions is a good topic with which to contemplate the pressure to harmonize even where the harmonized element begins in optional form. As firms elect the CESL for cross-border transactions, we can be sure that countries, not to mention the authorities in Brussels, will try to make the law mandatory. Even if this is not the case, as some firms elect the law because it is attractive to them, other firms will find that parties resist transacting unless they too agree to opt in to the CESL.

Consider by way of analogy the fact that credit cards have spread, though their use is optional at the enterprise level. Firms need not accept them, and consumers need not carry them, but as they become ubiquitous one is at a serious disadvantage without them. Universality does not prove desirability, and does not eliminate the costs imposed on the minority that was dragged in to the system. Another, more provocative, example is found in the evolution of smoking regulation, which has evolved from opt-in to mandates in many jurisdictions.

welfare by creating many more lucky median voters–by making jurisdictions smaller and smaller, much as markets segment to serve a variety of consumer tastes. In the extreme case, if each individual opts in to his own consumer law or commercial law, then everyone's preferences can be satisfied. Note that a jurisdiction can be large for one purpose, such as national defense or currency, and much smaller for another, as is true in some places for public schools and traffic management, and could be true for commercial law. Indeed, the optimal jurisdiction size for one question of commercial law may well be different from that appropriate for another. The thought experiment reminds us that each jurisdiction has already harmonized, or unified, laws covering those who live within its borders (except where it has chosen not to issue mandatory regulations). There is no reason to think that it will maximize welfare by maximizing coercion through unification. The problem with too much individual choice, of course, is that scale brings advantages, most notably a reduction in various transaction costs. In area after area of law, individuals would trade away some autonomy in return for lower prices, coordination gains, and so forth. If we allow everyone to make his or her own laws, there will be substantial interaction costs, or simply much less trade. Among other things, this tradeoff pushes large swaths of law into one package when it comes to the size of the jurisdiction in which it will prevail.

As the title of this Article (and Part) suggests, the framework is also meant to remind us to incorporate Buchanan and Tullock's notion that a majority can be expected to impose "external costs."[9] Inasmuch as I intend to contrast commercial law with other government actions, it is useful to dwell on the external costs problem, which is in some tension with the median voter perspective. The analysis is first framed in terms of individuals within a jurisdiction, but it is the same for numerous jurisdictions within a union; there is a median voter at both levels, and at both levels there is the problem or temptation of external-cost imposition.

Consider three different cases. In the first, a simple majority votes to build a new road at the expense of all taxpayers. Buchanan and Tullock develop the idea that the majority might make an inefficient choice as to where to locate the road or whether to construct it at all because 49% of the cost of the road is borne by the minority. The majority can build a road the minority would oppose, perhaps simply by locating it where it is useful to the majority alone. If the decisionmakers enjoy 100% of the benefits but pay only 51% of the costs, they are likely to overbuild. The smaller the share of costs paid by the majority, the greater the inefficiency problem. In the second case, the

[9] Buchanan and Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (University of Michigan Press, 1962).

assumption about uniform taxation is relaxed, so that the majority can draft not only the road plan but also the tax law, so that it can burden the minority and not itself. The inefficiency problem is yet greater; the majority can gain all of the benefits and pay none of the costs. If it can *externalize* costs in this manner, it will build roads it barely wants, though these are costly to others. It goes without saying that the example is oversimplified; among other things, it ignores the ability of the minority to turn this into a "mere" wealth transfer problem, by paying the majority not to build the road.

In a third version of the external cost problem, the majority is constrained and able to force expenditures by simple majority vote only with respect to pure public goods. Things like roads are paid for with user fees, or by taxes that are unanimously approved, or they are not built at all. Still, public goods are not identically valued by all participants, and the majority might order an inefficiently high level of a public good because the majority values it more than the minority, though not enough to pay for it by itself. The problem of external costs is solved only if majorities are unstable, so that a minority with respect to one spending program is in the majority in the next go around, and there is a possibility of open or subtle bargains so that all majorities refrain from imposing external costs. There is little evidence for such an optimistic resolution.

It is plausible that the external cost problem is greater in smaller jurisdictions than in larger ones. Two voters can impose external costs on one, and a small number of players is likely to be better at maintaining a stable majority, and exploiting the minority in repeat fashion, than is a large number. A smaller jurisdiction is also likely to have homogenous voters who will form a majority and be confident that they will have similar preferences across many issues. Workers living near a factory or farmers who grow the same crop in a suitable valley come to mind. On the other hand, in many cases it is easier for an exploited minority to exit from a smaller jurisdiction without severing employment and familial ties.

Fortunately, the external cost problem is largely limited to cases where expenditures are concerned, and does not extend to all law. A good deal of imagination and many assumptions are required before the most severe external cost problem can be brought about by government regulation rather than spending. By way of illustration, products liability law may be voted in by a majority and imposed on a minority, but the costs are spread across most purchasers and the presumed benefits will flow to some subset of these purchasers, and then some other parties as well. The match between burdens and benefits is imperfect, so there is room for the majority to externalize some costs, but the problem is modest compared to what is possible when a majority contemplates an excise tax to fund a new bridge. Other regulatory law is more suspect on

these grounds. For example, environmental regulations may benefit the majority, while it imposes cleanup costs on a completely different, minority, group. With such a mismatch, the majority, or even a well-organized interest group, might easily pass inefficient regulations.

Readers will have disparate intuitions about where commercial law fits in this scheme, and that may depend on the level of coercion in an initial, harmonized code. Most of commercial law is surely more like products liability and less like environmental regulation; it is certainly not like bridge building with an excise tax on an unrelated good or activity. It is tempting to say that commercial law resembles none of these because much of it allows parties to contract out; in the case of the CESL the default is reversed and enterprises opt in rather than out. Where opting out is the rule, contracts may be costly, and for many parties and transactions the default position is all that matters. Even when there is no formal coercion, as others opt in one suffers costs by not doing so. In any event, there is reason to think if a code like the CESL has relevance, it will quickly take the opt-out form or even be imposed by the majority on certain transactions; it is hard to resist the benefits associated with imposing external costs and competitive disadvantages on others. If so, then it is worth pointing out that there are many areas of commercial law where courts are hostile to provisions, like liquidated damages, that attempt to contract out of default terms provided by law. In other areas, like credit transactions, it is difficult to contract out because of third-part effects. It is, for example, difficult to contract around payment systems or the priority rules of most secured transactions regimes.

Law may rarely be a pure public good, but it is difficult to exclude those who wish to make use of it. Its benefits cannot normally be restricted to 60% of the population while the other 40% pays for it. It could be structured as more of a private good. One can imagine charging litigants for the use of courts and collecting substantial user fees from debtors for such things as the law of secured transactions. The typical legal system, however, charges modest fees for these benefits and provides a publicly supported system, albeit one that produces precedents, trade, and other positive externalities. Thus, legal institutions, though they may arise out of a desire to impose preferences through harmonization, are likely to reflect the first type of majoritarian advantage, with its attendant external costs. The majority will impose more law than is efficient, and certainly more than it would pay for on its own, because it can share costs with those who will not benefit. The situation in which the external costs problem is greatest, as illustrated by the case where the majority can build roads it alone enjoys while it succeeds in taxing the minority to pay the entire cost, is very hard to reproduce where

lawmaking, rather than spending, is involved. The most important sorting, but also the greatest danger from sorting, is unlikely to apply where harmonization of enabling or regulatory law (as opposed to taxing and spending) is at issue.

This is hardly the place to generalize about optimal legal areas, for that is a matter complicated by the question of the gains and losses from harmonizing some things but not others. I have already noted that the optimal size is likely to be different with respect to every question, and this may be so even within commercial law. One might want a large jurisdiction for defense, a small one for consumer law, a bit larger for secured transactions, a different size still for road building, and so forth. But it is clear that these various optima make the question of effective political representation extremely difficult, and the relative power of interest groups even harder to assess.

6. Conclusion: convergence and compacts

The United States hardly needed harmonized commercial law to promote a sense of national identity, and yet its commercial law is fairly well harmonized, both where merchant-to-merchant transactions are concerned and, increasingly, where consumer law is at issue. There is no obvious evidence of significant cost externalization in this commercial law system. In the American experience we find another clue about harmonization; it came about largely through convergence. By convergence I mean, first, that different jurisdictions converged on the same legal rule, without any authority pushing them to do so.[10] In the most interesting cases convergence evolves across legal systems, without borrowing and even without knowledge of the other legal system. In the United States there has been some coerced harmonization (because of federal law regulating some consumer law, securities law, and so forth) but also convergence by state legislatures and courts, though hardly without awareness of other jurisdictions. Most significantly, model codes, such as the Uniform Commercial Code, have been drafted, and states have been free to adopt these codes, often with minor local adjustments. A clever political or psychological aspect to these opt-in codes, is that states do not feel as if another state was triumphant.[11] The "winner" is a code usually drafted by nonpolitical actors, influenced greatly by organized interest groups but normally incorporating a drafting committee eager to draft the best possible law. These interests keep an eye on the politics of adoption by state legislatures but it would be a mistake to minimize their

[10] Levmore, "Variety and Uniformity in the Treatment of the Good-Faith Purchaser", 16 *Journal of Legal Studies*, (1987), 43-65.
[11] In other words, everyone bears switching costs. See Carbonara & Parisi, op. cit. *supra* note 4.

desire to find the best answers. Second, there is convergence at the enterprise level. For example, one insurance company develops a form, and then because its terms are litigated, it becomes advantageous for other firms to use the same form, and it eventually becomes standard. One landlord or printing company draws a lease, and then others copy it, perhaps because drafting one's own lease signals potential bargaining partners that one is strategic. Convergence as to terms also makes price comparisons more straightforward. Convergence thus occurs even, or especially, where—as in the world of the CESL—harmonization is completely optional.

A good argument for EU harmonization with respect to commercial law is that harmonization in the United States, and certainly in China, is further along than in the EU, and apparently successful (though it is difficult to evaluate the counterfactuals). There is no evidence that states try to diverge or to separate from harmonized commercial law. Smaller units do try to serve as experimental zones, and Hong Kong might be thought of as an example of diversity rather than harmonization, but inasmuch as most observers would say that it represents a step toward a harmonized result, I will not dwell on that exception. In any event, harmonization in the United States came not from central directives but from convergence. Nothing has stopped the members of the EU from converging on one law. It might be said that in many cases members of the United States converge with respect to commercial law and many other kinds of law because they know that if they do not, there is a good chance that federal law will develop and will preempt state law, with no room for dissent or even minor variations. Convergence and soft harmonization is thus often in the shadow of the threat of strong harmonization–though there is no evidence for this in the case of business-to-business commercial law. Whatever the extent of this effect, it seems impossible to say whether welfare is maximized under current U.S. law. Local variation may reflect local preferences and may increase welfare, or it may reflect overachieving interest groups and may be unfortunate in its imposition of transaction costs. Nor is there much to learn from the relationship between local variation and national identity in the United States.

Imagine that fifteen of twenty-seven jurisdictions in a federation are relatively homogeneous in the sense that the majority coalition in each of these jurisdictions sees that its preferences are sufficiently similar to those of the majority coalition (or median voter) in the other fourteen jurisdictions that it would prefer to abide by the laws of its like-minded partners than it would to the (unknown) decisions of the future majority of the twenty-seven. Alternatively, some members of the fifteen have intense preferences about some matters, and the group of fifteen is like-minded on these matters. The case is ripe for the imposition of external costs. Imagine further that there are restrictions on

expenditures or taxes, perhaps because members of the federation sought to protect themselves from the external costs problem. The subset of fifteen can, therefore, maneuver only with regulatory law. In such cases, the fifteen would be better off agreeing to agree in the future.[12] This power of a precommitted caucus, or subgroup, is familiar to students of political parties. In the American constitutional system it is combatted by a rule requiring congressional approval of state compacts; several states cannot simply form a binding alliance. But it is clear that if a coalition of members, or elected representatives, could oblige themselves to vote alike in the future they would gain at the benefit of their disorganized allies. The reasoning behind this counterintuitive claim begins with the assumption or requirement that each voter (each jurisdiction in the compacting group, or each senator in the set of senators contemplating such a pact) expects more often than not to agree with the majority of the group. We began, after all, with the assumption that a subset had similar preferences. If so, it is beneficial to agree to vote with the majority of one's subgroup on *all* matters, as the agreement leverages one's own vote a majority of the time. A second step, or corollary, is that the compacting group will then prefer for more matters to be decided centrally rather than be left to local preferences and votes, because each member of the compacting group has more power than the nonmembers where central decisionmaking is concerned. The analogy for a federation, or for the EU in particular, is that a like-minded subset will prefer for more things to be decided by directive, or in some other centralized manner. Federations have a way of combatting this compacting, or subgroup, problem. They can hope to enforce a plain ban on subgroup precommitments to vote together in the future. Alternatively, they can require various matters to be decided by supermajority.

Note, however, that the federation should not be expected to combat the power of the organized subgroup by opposing harmonization. Harmonization can be expected to increase the influence of the central bureaucracy, though the details of harmonization are likely to reflect the preferences of the overachieving, organized subgroup.

It seems plain that a self-identified minority, not empowered by "membership" in a like-minded subgroup, should generally resist harmonization. In the context of the European Union this means that a jurisdiction that thinks it is more likely to be exploited than it is to exploit others should oppose harmonization with respect to something like commercial law. Nothing stops it from allowing its laws to converge on the majority's, much as its citizens might over time dress in the fashions prevalent in other countries, without committing to do so through any law. Fashions at home and abroad can change,

[12] See Levmore, "Precommitment politics", 82 *Virginia Law Review* (1996), 567.

and it would seem strange to agree in advance to abide by conventions set by others in return for very modest gains in trade.

In contrast, jurisdictions (like individual voters or representatives) that see themselves as part of a stable, continuing majority with similar preference should normally prefer *more* central decisionmaking, including harmonization.[13] There is the danger that the ability to externalize costs will generate inefficient laws, as might the advantage of a kind of compact that dominates disorganized states, but that is of no concern to the majority. If the primary consequence of harmonization, whether intended or not, is the development of a single political and cultural identity, then there is the question of whose identity and values will dominate, and the most likely result is that harmonization will favor the stable majority. Perhaps those who most favor strong harmonization in the case of EU commercial law are those who expect to win this culture war regarding European identity.

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[13] Multinational firms may benefit from harmonization because it reduces transactions costs, but I hazard no conjecture on the question of political influence. Some large firms might do better dividing and conquering at the local level, while others might be perceived as gaining power when the they need only influence central decisionmaking.

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