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

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I. Introduction

All harmonization is not equal. When it comes to child labor, 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, which is to say those harmonized in the extreme. 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. Can we explain these intuitions, or developments? And how might such an explanation illuminate the optimal level of harmonization when it comes to consumer protection and commercial law in the European Union and other evolving alliances?

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 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. The alternative might be more attractive, or even available, only for cross-border transactions. The Draft Common European Sales Law (CESL) fits this description, and it offers an opportunity to think specifically and generally about harmonization.

Part II begins quite generally with the relationship between local preferences and harmonization—or its opposite. Part III takes a brief detour to include the role of

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harmonization in promoting national, or union-wide identity. Part IV explores the origin of local “preferences” in order to understand what is or is not to be harmonized. The role of the median voter is emphasized, and opt-in regimes are contrasted with more coercive laws. Part V compares the inefficient moves a majority might make because of its ability to exploit, or impose “external costs” on a minority, especially when the minority is coerced or otherwise excluded from many transactions. These inefficiencies are different with and without harmonization, but they can illuminate the winners and losers from harmonization. Part VI concludes and contrasts harmonization with mere convergence over time.

II. Preferences as a Source of Harmonization or Variety

Among the cited examples, child labor and arts funding seem especially distant from commercial law, and also easiest to understand. With respect to the first of these, it is plain that the employment of young children in (even) distant economies horrifies most observers in “advanced” economies where child labor has been outlawed. No one advocates complete and disparate self-determination on this matter,¹ and no one calls for “soft harmonization” among cooperating jurisdictions. There is, instead, strong sentiment among elites, though not libertarian-inclined economists, to project or impose preferences, or moral sensibilities, where other people’s human rights are concerned. There are two conventional explanations for this failure to respect local preferences. The first is that the victims, or losers, 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 simply find it exotic when Country B’s citizens bow to a monarch, but that tolerant or even envious reaction is normally conditioned on a perception that these citizens could have dethroned the ruler if they chose; child labor, torture, serious discrimination, and even capital punishment are quite different. Still, the objection to child labor is louder the more B is a neighbor or ally of A, and it is difficult to see why this ought to be so, unless A’s citizens recognize that they should be cautious in projecting their own cultural norms and are therefore more comfortable doing so when the target of their outrage is a well-known or similarly situated place. Proximity may also provide better information, so that those who would

¹ There is a respectable, libertarian case to be made for local preferences, and of course a poor family and society might be better off with child labor. Still, I choose the example because at a sufficiently low age, even the most determined libertarians will hesitate to entrust parents with the welfare of their children, where parents do not invest in education, and prefer immediate returns.
impose their own preferences are more confident that the rate of return on education (and safety by staying away from the workplace) is much higher than what a family can derive from the labor of young children. Child labor is a relatively safe case because the moral outrage it provokes is near the end of a spectrum. Some of A’s citizens might also 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 possible or even likely that this explanation for, or subset of, harmonization has little bearing on our subject, except to remind us that harmonization can come from preferences about other people’s lifestyles and well-being.

A second explanation is that one’s own moral sensibilities with respect to the behavior of others are heightened when there is the perception that one loses out to competitors who behave less justly. If a jurisdiction prefers nicer parks, and raises taxes to finance these parks, 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, and indeed are forced to pay more fully, 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 (or “fairness”) case for harmonization, arises either where human rights are concerned or where mobile taxpayers are perceived as evading a responsibility and threatening to drive jurisdictions to a lowest common denominator where other-regarding preferences are at issue.

Regulation is comparable to spending. The domestic regulation of child labor might raise the cost of doing business, and this will encourage some businesses to expand in unregulated jurisdictions or to migrate to those places. Domestic interests will think this unfair, and perhaps especially so because it seems to generate a race to the bottom. The regulation can be seen as equivalent to a decision to pay children to go to school

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2 I recognize that a jurisdiction has no preferences, but that the people within it do so. In the interest of clarity and brevity 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.
rather than to take up employment, followed by the risk that businesses will choose to escape the taxes levied to pay for such a program.

Note that a jurisdiction might combat some part of the feared race to the bottom by regulating consumption rather than (or in addition to) production. Its law might simply forbid the consumption of goods made with child labor, or it might tax such goods heavily. A mixed approach could bar domestic production and then ban imports that exploit child labor. In any event, the problem with promoting a moral agenda, or deflating competition with noncomplying jurisdictions, through bans on consumption, is that enforcement costs are often high. A jurisdiction would need to have information about production methods in other countries in order to identify offending goods, while the domestic regulation of production often involves paying attention to 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. The last step can run afoul of international trade agreements, but even if we set aside this legal hurdle (as perhaps relaxed where child labor is concerned), the problem is more difficult than first appears. Goods made with child labor can be channeled through third countries, and, at modest cost they can be sold in the country that sought to exclude them. Finally, some nonoffending but otherwise identical goods can be imported from other countries, and child labor will continue so long as there is a market for the cheaper goods in some country. If the goal is to decrease the use of child labor, rather than simply to avoid tainting oneself by association, then these end runs and substitutions must be blocked.

This initial example will seem rather remote from commercial law, in part because we do not think of harmonization with respect to child labor laws as having anything to do with reducing the transaction costs among trading partners, and that is likely to be the stated justification for harmonizing (or opting in to an alternative set of rules governing) commercial law. Still, preference satisfaction, or protection, may be

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3 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, as we will see, nothing stops a jurisdiction from enjoying an economy of scale by allowing its commercial laws to converge with others. Harmonized laws might be a step towards political unification, which brings its own scale economies, but that is something the EU does or does not have regardless of the extent of variety in commercial law. These features of harmonization reflect the very useful and insightful framework (as well as skepticism) advanced in David W. Leebron, Claims for Harmonization: A
more important than transaction costs in terms of motivating harmonization. At the same time, the child labor example is intentionally misleading or unusual; the “preference” for a world without child labor leads to harmonization, while most strategies for satisfying preferences lead to respect for disparate practices, or variety in law or in markets, if only to satisfy disparate predilections within or across jurisdictions. It is apparent that this is most easily accomplished only where preferences within a jurisdiction do not lead it to wish (and be willing to pay so) that other jurisdictions’ practices reflected the same preferences.

Prior to turning more directly to commercial law, it is useful to see one other distant example, where preferences are not normally exported but where (as is more common) they lead to variety and not harmonization. Government support for the arts provides a useful illustration. One might feel strongly that one’s government should support ballet companies, rather than have those entities rely entirely on patrons, or user fees, but it is rare to see political capital expended in order to encourage a foreign jurisdiction to support that art form. To be sure, businesses might migrate in order to avoid taxes that support the ballet or other arts, but most jurisdictions are able to use individual, rather than business, taxes for this purpose. Moreover, few patrons make a habit of travelling to foreign jurisdictions in order to enjoy ballet subsidized by others, at least not without spending a great deal of money in the host jurisdiction. 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 academic. Moving is costly and even prohibitive for many residents; governments are

Theoretical Framework, 27 Canadian Business Law Journal 63 (1996), which also cites earlier work on the subject.

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. Emanuela Carbonara & Francesco Parisi, The Paradox of Legal Harmonization, 132 Public Choice 367 (2007), seems to adopt this starting point, and then proceeds 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. 4 Fernando Gomez & Juan Jose Ganauza, An Economic Analysis of Harmonization Regimes: Full Harmonization, Minimum Harmonization or Optional Instrument [citation needed] 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. I try to avoid repeating their arguments, though the median voter discussion below reflects some of the same thinking about the likely compromises that are made when two or more jurisdictions harmonize their laws.
unable to promise the continued provision of particular goods;\textsuperscript{5} and there are too many goods and too few jurisdictions that will accept migrants. A modest amount of sorting is the best we can expect.

III. Harmonization and a “Preference” for Shared Identity

Why are arts ever supported by the central government in a federation? There are at least two good answers, and both are relevant to the present inquiry. First, there may be an interest group that is well enough organized to defeat local interest groups. The interest group that wants to export 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 and brought about a result that simply served a better organized group 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 these battles.

The second, more far-reaching reason for central support is that the authorities, or certain elites with political power at that level of government, might see such a policy as a useful means of promoting national 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 to Mandarin, which became the language of government, of the school systems, and of most television stations. Of course the Chinese example might seem more relevant if it had been offered as an alternative, and then enough local governments, businesses, and schools had “opted in” to make it more costly for those who first declined to switch to Mandarin to remain outside the new mainstream. In any event, economists have some trouble with these goods or arguments, because the idea is not just to satisfy preferences, but first to alter them. 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

\textsuperscript{5} 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. But these are exceptions that prove the rule.
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, we might imagine that academics and bureaucrats will favor many projects and laws that promote a European identity. In order to succeed, the harmonization must not antagonize the provinces, so we would not, at least at the outset, expect too much in the way of mandatory terms. Indeed, the alternative that is now ascendant in the EU, a common, centrally-planned, commercial law that is available as a matter of choice (especially outside of consumer transactions) not at the jurisdictional level but at the enterprise level,

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 because of the potential for reduction in transaction costs (though they might also have a competitive advantage over modestly sized firms if there are local laws to navigate and transaction costs to bear). 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 familiar market), 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. Bureaucrats will prefer harmonization for very different reasons, chief among them the idea that harmonization in nearly every area of law promotes a shared identity.

IV. Sorting versus Median Voters

A good deal of commentary observes that harmonization is likely to destroy or deny the welfare gains obtained when jurisdictions differentiate themselves and citizens can sort themselves into jurisdictions. But such sorting is not the only way to accommodate disparate preferences. When decisions are made in constituent jurisdictions, they 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 idea, 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. 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 most 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, these 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 modest interest in 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 case 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.6

It might be objected that many questions of law have right answers or best practices, across a wide range of preferences. For example, the speed limit on commuter bridges might be similar in different jurisdictions, but in fact 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 experimentation, rehabilitation, and expenditures on improving prison conditions are concerned. Even the question of when and where to use a jury is likely to implicate preferences about jury service, inconsistent outcomes, and so forth. To be sure, the median voter in a jurisdiction might also have a preference about the desirability of harmonization, and mixed into this

6 I recognize that in odd cases, the jurisdictions might bargain for a point that outflanks their prior equilibrium points. See ___ supra. One’s imagination is a bit stretched here because harmonization impulses come more often from experts than from voters. Indeed, if citizens are asked to vote on the matter, we often anticipate that they will reject harmonization in favor of the sovereignty or cultural values they attach to inherited, local law.
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.

Prior to enriching the analysis with 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 less about preferences than other areas and because in its current life the CESL is optional—especially where business-to-business transactions are concerned and, there, so much so that 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 (with the exception of consumer protection) not only has much more to do with right answers, or transactional efficiency, than with preferences, but also deals rather directly with trade among jurisdictions and, therefore, implicates transaction costs more than do most other subjects. The median voter surely wants these 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, and these can be understood as preferences. 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. A second, less significant trigger of preferences is the

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7 I try to simplify the discussion by thinking about median voters and harmonization, though there are obviously principal-agent problems between voters and their representatives and also between legislators and “their” regulators. Consumer protection law is likely the area within commercial law where the principal-agent problem between legislators and regulators is be greatest, and thus
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. 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 tolerance for forcible repossessions and garnished wages, while others will reflect judgments about how much risk consumers should bear in return for lower prices. Some of these legal questions bear on the poor and powerless and thus might show small specks of resemblance to the child labor laws discussed earlier.

I turn next to the highly optional nature of the CESL. At least where that mild form of harmonization is concerned, why think in terms of the median voter and, as we are about to see, of the ability of a majority to exploit a minority, when an enterprise will likely be able to decline to be governed by the CESL? One response is that the law with respect to consumers is unlikely to be optional here or elsewhere. Another is that as firms elect the CESL for cross-border transactions, say, their countries, not to mention the authorities in Brussels, will try again to make the law mandatory, or mandatory for a set of transactions. Even if this is not the case, as some firms elect the law because it is attractive for them, other firms will find that parties resist transacting unless they too agree to opt in to the CESL. And of course if all this is imagined, and no one chooses it, then the CESL is of no relevance in the first place.

the role of harmonization in advancing the cause of one or the other the greatest. David Andrew Singer, Capital Rules: The Domestic Politics of International Regulatory Harmonization, 58 International Organization 531 (2004) thinks of harmonization as a tool for satisfying domestic political pressures rather than the regulators own preferences. At times the discussion in he present Essay reflects the opposite intuition, but the important point is that the discussion simplifies by ignoring the friction between regulators and elected representatives.

8 The role played by culture in creating friction (or noncompliance) for harmonization is discussed in Gerda Falkner, Oliver Treib, Miriam Hartlapp, & Simone Leiber, Complying with Europe: EU Harmonization and Soft Law in the Member States (2005).

9 Available analogies are imperfect but suggestive. Firms are not required to accept credit cards, and consumers are not required to carry them, but over time one is at a serious disadvantage unless one opts in. That credit cards are nearly universal does not prove that they are desirable, or that they do not impose serious costs on the minority that was dragged in to the system. Another, more provocative example, is found in the evolution of smoking regulation. Thirty years ago,
V. 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 welfare by creating many more lucky median voters—by making jurisdictions smaller and smaller. 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 issuing 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. The optimal area 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 regulate). There is no reason to think that it will maximize welfare by maximizing coercion through unification, having more rather than less law within the jurisdiction. 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 Essay (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.”10 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 businesses were free to restrict or ban smoking, and customers could opt in to a no-smoking environment in the sense that one chooses restaurants and other businesses to patronize. Although many individuals (by all accounts) preferred a no-smoking environment, it was extremely rare to find any opt-ins. It is perhaps for this reason that interest groups moved to mandate no-smoking zones within business premises—and these rules soon expanded so that opting out was nearly impossible.

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 assumption about uniform taxation is relaxed, so that the majority can also tax 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 the 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 costs 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 is imposed by regulatory law. Thus, 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 is not perfect, so there is some externalizing of costs, but it is rather tame 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 a group, or the majority, while imposing cleanup costs on a completely different group, or minority. With such a mismatch, the majority, or empowered interest group, might easily pass inefficient regulations. Different readers will have different intuitions about where commercial law fits in this scheme, and that may depend on how coercive it is in its first form, but a first cut suggests that most of commercial law is more like products liability and less like environmental regulation, and 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—or in the case of the CESL will likely begin with a framework that calls for opting 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. And where there is no coercion or default to opt out of, it can still be the case that as others opt in one suffers costs by not doing so.\footnote{See supra note __.} In any event, I continue to assume, perhaps to the annoyance of readers, that if 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-party 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—as we could, for example, charge litigants for the use of courts and collect user fees from debtors for the law of secured
transactions—but it cannot normally be restricted to 60% of the population while the other 40% pays for it. The more a given harmonization project arises out of the desire to impose preferences, the more it is like that first type of majoritarian advantage. The majority will impose more law than is efficient, even as measured by its own preferences, because the costs are borne by all. The situation in which the external costs problem is greatest, namely 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 lawmakers, rather than spending, is involved. The most important sorting, but also the greatest danger from sorting, is unlikely to apply where harmonization of law (as opposed to taxing and spending) is at issue.

This is hardly the place to make conjectures 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 all these different optima make the task of political representation extremely difficult, and the relative power of interest groups even harder to assess.

VI. 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 even 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.12 In the most interesting cases there is convergence across legal systems without borrowing and, indeed, even without knowledge of the other legal system. In the United States, there is some forced harmonization (because there is federal law with respect to 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, are drafted, and states

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12 [Cite literature on Variety and Uniformity.]
are 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.\textsuperscript{13} The “winner” is a code usually drafted by apparently nonpolitical interests, influenced greatly by organized interest groups but normally incorporating a drafting committee or other influential group 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 desire to find the best answers. Second, there is convergence at the enterprise level. 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 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 extract themselves 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. But 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.

\textsuperscript{13} In other words, everyone bears switching costs. See Carbonara & Parisi, supra note __.
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 in this group 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 closer on these matters than others. In other words, imagine a case that is ripe for the imposition of external costs, but imagine that there are restrictions on expenditures or taxes, so that the group of fifteen is concerned only with regulatory law. In such cases, the fifteen would be better off agreeing to agree in the future. This power of a precommitted caucus or subgroup is familiar to anyone who follows party politics. It is combatted in the U.S. constitutional system by a rule requiring congressional approval of state compacts. But it is clear that if reasonably like-minded coalitions could bind 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 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. If so, it is beneficial to agree to vote with the majority 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 majority 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. They can require various matters to be decided by supermajority. Finally, they can stress the advantages of harmonization. This is an especially attractive option if it will be difficult to reverse harmonization, and if those who opt in to it, or are coerced to join, will be bound by new laws and add-ons to that which is agreeably harmonized.

It seems plain that a self-identified minority 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

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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, 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 should normally prefer more central decisionmaking. 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, for example, the true benefit—or an important but unintended consequence—of harmonization is the development of a single political and cultural identity, then there is the question of whose identity and values will dominate, and there is the likelihood 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.