

Private Sources of Trust and Recourse: Prerequisites for the Successful Emergence of Markets in Cyberspace

Bruce L. Benson*
Florida State University

Introduction: a lack of trust in emerging markets and the potential role of law

The availability of low-cost, high-speed computing, along with several other innovative developments such as computer networking that creates the possibility of *Acyberspace@* (the linking of numbers of people as if they were meeting in physical space), offers a way to conduct business trades (and many other kinds of transactions) almost instantaneously and at very low costs (Bennett, 1999a:1) These technological advances would appear to be so significant at lowering trading costs, that cyberspace should become a primary location for international commercial transactions. And commerce is expanding on

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the internet at a substantial rate. Small-scale cyberspace transactions (retailing) certainly is developing, and many firms that have established reputations in real-space commerce are employing the

internet to reduce transactions costs. However, the potential for rapid expansion of large-scale trade through cyberspace, particularly by new firms, may be constrained, as much of the cyberspace economy can be described as a low-trust society (Bennett, 1998: 1). Trust certainly can evolve to support trade, as explained below, although under some circumstances it can be limited to relatively small trading communities. Thus, recourse in the form of third party dispute resolution and sanctions against breaches of contract may be necessary as a substitute for trust in order for some types of large-scale trade to emerge in the cybereconomy. If trust relationships prove to be difficult to establish then an important question becomes, how should recourse be provided to facilitate the emergence of even more cyberspace commerce?¹

¹Indeed, while the focus here has been on the emerging markets of cyberspace, the same question arises for all emerging economies, whether they are in cyberspace or physical space (e.g., the emerging economies of the formerly communist and newly independent nations of Eastern Europe, the growing markets of still communist China and Vietnam, the economies of many Latin American countries that are attempting to escape their histories of plunder by military dictatorships), and the answer is also the same (Benson, 1999b, 1999c, 2000b).

If a legal system can be called upon to resolve contractual disputes and sanction breaches, then promises may be credible even in the absence of trust. Not surprisingly, many observers are advocating increased government involvement to provide law and order for cyberspace (although many of them are less concerned with contract enforcement than with issues like pornography, tax avoidance, transactions in illegal commodities or services like gambling, etc.)². In reality, however, less state involvement in commercial law is called for at this stage of market development, not more (Benson, 1998b, 1999b, 1999c, 2000b). This does not mean that commercial law may not be required, but as explained in Benson (1999b), it means that the commercial law should be established by institutions other than the state. The following presentation explains that the same non-state sources of law that are likely to be more effective at supporting trade in international trade and in the emerging market of geographic space (Benson 1999b, 1999c) are also likely to be more effective in cyberspace (Benson 2000b) a polycentric system of customary law. Before doing so, however, the means by which trust evolves are briefly discussed in Section II in order to emphasize that trade can occur without law, and therefore, that recourse is in fact a substitute for trust. Customary law is described in Benson (1999b) and its use in international trade is discussed in order to illustrate how it works (e.g., what the institutions for resolving disputes and sanctioning law breakers are).

²In this context, some technologies are clearly threats to the state's ability to regulate and tax. For instance, public-key encryption provides a secure way of coding text, voice, and any other transmission so that transactors can verify the identity of a trading partner based on the public key, in the sense that they know that they are dealing with the same identity that they dealt with in the past, and yet no one need know the actual identity or geographic location of the trading partner. Digital currency based on public-key encryption then allows values to be transmitted through cyberspace in exchanges between parties who do not know each other's actual identity or location. This means that internet commerce can avoid many of the regulatory and taxing burdens that limit commerce in geographic space, perhaps providing a powerful incentive to move even more transactions into cyberspace than would occur in the absence of government interference with markets in geographic space.

Section III simply focuses on the potential for customary law arising in emerging markets of cyberspace.

Potential sources of trust in cyberspace

If the full knowledge assumption of neoclassical price theory is adopted, there is no reason to worry about institutions that facilitate trade. If traders know everything there is to know about their trading partners' products and there is no uncertainty about the future, all promises are credible and no one can be cheated. In such a zero information and transactions cost world, property rights do not even have to be assigned, since efficiency will prevail and rights will simply arise through the costless bargain (Coase, 1960). In reality, however, knowledge is not free nor is it uniformly distributed, ignorance abounds, and the future is very uncertain (O'Driscoll and Rizzo, 1985). Therefore, institutions evolve as a substitute for knowledge. Trust is such an institution (along with money, money prices, and as explained below, recourse or law). If a buyer does not know everything about the product being purchased, while the seller actually knows much more about the product (asymmetric information), and the future is uncertain, the buyer still may make the purchase (believe the seller's claims about quality and promises to deliver, etc.) if the buyer knows enough about the seller to trust her.

It is widely recognized that repeated dealings create an environment conducive to the development of trust, because they create incentives to employ cooperative strategies (e.g., live up to promises). In emerging economies, such as the internet, repeated-dealing arrangements must be initiated, however. Furthermore, such reciprocities do not guarantee cooperation (Tullock, 1985), since the loss of future benefits from an ongoing but somewhat uncertain exchange relationship is a cost that must be weighed against the immediate gains from cheating by misrepresenting quality or by refusing to live up to a contractual obligation. Thus, transactors' time horizons and discount rates are important determinants of the incentives to cooperate when cooperation incentives arise from repeated dealings. And when the cost of shutting down and starting up in a new location and/or identity is low, as it may well be in

cyberspace, the cost of losing a repeated-dealing arrangement may be relatively low too.

Cyberspace geography is very different from physical geography, as physical distance is relatively unimportant, particularly for many financial transactions (material goods still must be delivered after a transaction, of course, but reduced transactions costs and gains in scale can offset shipment costs in many situations). At the same time, the relative unimportance of physical space also raises transactions costs since someone who reneges on a promise can easily escape into any of a virtually unlimited number of parallel universes (Bennett, 1998:1). Thus, it may be more difficult to make cyberspace promises credible in any two-party exchange than it is to make promises in physical space credible. Indeed, cyberspace may be very attractive to the con artists and hucksters who prey on the ignorant and greedy by making promises, collecting payments, and fleeing into a new identity rather than delivering on the promise. How can a cyber trader distinguish between new entrants and fly-by-nighters in order to initiate a potential repeated-dealing arrangement in the first place?

The same problem also arises in geographic space, but in such physical-space transactions a number of indicators of quality and credibility exist. For instance, private sources of quality information and regulation are provided in some cases. Travelers often stay in a hotel or motel in a particular town for one night, for instance, and never deal with the same local hotel again. However, travelers who are concerned about the quality of such establishments can consult the American Automobile Association (AAA) guide or some other rating publication that they trust, or they can stay at a Best Western hotel, which essentially is a private regulating arrangement, since independently-owned motels must meet specified quality requirements to have Best Western status (Holcombe and Holcombe, 1986).

[Another option is to stay at one of the many national chains, of course, so repeated dealing occurs with the firm even though it does not with the individual location, and these firms also have reputations, as discussed below]. The same kinds of information and

private regulation are available for many other types of products. One can consult *Consumer Reports* or one of the other testing services, for instance, or look for the A Good Housekeeping Seal of Approval[®] before buying many products. These same kinds of services are beginning to arise in cyberspace. Merchants spotlighted by America Online are accredited by America Online's Certified Merchants program, for instance. On some sites you can also find the CPA A Web-Trust[®] seal, which means that the company has been certified by the WebTrust program of the American Institute of Certified Public Accountants as meeting the program's standards for A sound business practices and transactions integrity.[®]

Even in the absence of information from independent third party rating services or private regulation arrangements, a party looking for a geographic space trading partner can, with a little bit of caution, deal with establishments that have invested in physical locations and in other transaction-specific kinds of assets that signal a commitment to live up to promises. An elaborate store front, costly advertising, and other non-salvageable investments are lost if the seller fails to live up to promises (e.g., about the quality of the product, contractual warranties, and so on), as information spreads and people turn to competitors who do live up to promises. In other words, when sellers make specialized investments that pay off only if they honor the terms of their contracts with buyers then they are seen as being more trustworthy (their promises are more credible), and the likelihood of exchanges increase. For instance, Nelson (1974) suggests that the advertising of experience goods serves two primary functions for the rational buyer, and neither of these functions focus on the provision of direct information about the experience quality of commodities that are advertised. First, advertising relates brand to function and provides information about the uses of the product. Second, and more important in this context, the volume of advertising relating to the experience quality of a commodity is a signal to buyers that shows the extent of committed investment by the seller. According to Nelson, then, what matters most to a rational buyer is not what advertising says about quality, but simply that the brand advertises and invests in non-salvageable capital widespread recognition of the brand name. If it is assumed that tastes cannot be

changed through advertising, then voluminous and/or expensive advertising (e.g., employment of a highly paid popular spokesperson like Michael Jordan; television advertising during the Super Bowl) of a brand suggests that the producer is committed to live up to claims made about the product. After all, why invest in establishing a brand name in the market for an experience good if through experience consumers discover that the brand is in fact a low quality product relative to others that are available. When consumers know of such investments, these non-salvageable investments can prevent opportunistic entrepreneurs from entering with the intent of appropriating the quasi-rents of established sellers.

Essentially, investments in non-salvageable assets are offered as a bond to insure credibility. For this arrangement to work, the buyers must be aware of such commitments, or hostages to use the terminology often applied to this idea since Williamson (1983). The specialized investments or bonds are held hostage by consumers in order to insure that the seller's promises regarding the quality of an experience good are credible. This implies, as Klein and Leffler (1981) explain, that the marginal cost to buyers of measuring such specialized or non-salvageable investments should be less than the prospective gains: If the consumer estimate of the initial sunk expenditure made by the firm is greater than the consumer estimate of the firm's possible short-run cheating gain then they will tend to trust the seller. The idea is that the investment, serving as collateral or being held hostage, must lose value if the firm cheats, so these expenditures need not give the consumer any direct utility. Cyberspace offers one advantage in this context. Information can be spread very rapidly and cheaply, so knowledge about someone's failure to live up to promises can be widespread. Of course, credibility enhancing investments in non-salvageable assets appear to be much more difficult to establish in cyberspace (e.g., advertising is very inexpensive, as are locations). Even though advertising appears to be inexpensive, high levels of advertising could be effective. Clearly, advertising is becoming extremely important in cyberspace as many web-sites and search engines survive on the revenues they get by selling advertising. However, potential consumers probably do not think that these investments are nearly as large (expensive) as the

advertising costs that characterize physical space (e. g., elaborate store fronts, celebrity endorsements, television ads during prime time, etc.), and as a consequence, cyberspace firms attempting to use this means of building trust have resorted to advertising in the physical universe too. More and more television and magazine advertising is being done by firms attempting to establish themselves in internet markets. Indeed, this appears to be the most rapidly growing segment of the advertising market.

Another non-salvageable asset also appears to be of considerable value as a bond in cyberspace reputation.³ After all, within certain business communities each individual enters into several different dealings with different trading partners. Thus, refusal to live up to an obligation within one transaction can affect the person's reputation and limit his ability to enter into other transactions to the extent that reputation travels from one transaction to another. When transactors choose trading partners based on their reputations, the potential benefits associated with refusing to cooperate in a single relationship will have to be very large for a party to damage an established reputation by renegeing on a promise or not accepting arbitration. Essentially, anyone who chooses a non-cooperative strategy in one transaction will have difficulty finding a partner for any future transactions (Tullock, 1985: 1075-1076). Therefore, in order to maintain a reputation for dealing under recognized rules of behavior (i.e., for fair and ethical dealings, including amicable acceptance of Afair@ dispute resolution), each transactor's dominant strategy is likely to be to cooperate throughout each transaction that he is involved in, whether it is a repeated or a one shot deal. Essentially, a reputation is a bond or a non-salvageable asset that can be offered as a hostage in order to make promises credible. Indeed, in many ways a reputation is an ideal hostage as it can have considerable value to the person who invests in building it, but no value to the persons (customers) who hold it hostage, so they have no reason not to destroy it if the reputable party reneges on a

³Yet another potential non-salvageable investment that is possible for cyberspace traders is an actual cash bond, as explained below.

promise. It takes time to build reputations, of course. An emerging internet market may not have many transactors that can offer valuable reputation bonds to contractual partners. Firms that have well established reputations in geographic space may be able to enter internet commerce and expand rapidly, however, and this clearly is occurring. New firms may have to suffer through a period of losses before they can expect to see their investments in reputation building pay off. However, the internet offers another advantage over geographic space in this regard. Information can be spread very rapidly and very cheaply. Thus, if a party reneges on a contract or fails to deliver the quality that has been promised, the other party often can retaliate by spreading the word that the other party is a non-cooperative player. AE-Bay@ offers a good example. Many of its traders are repeat players for whom reputation is becoming valuable. Indeed, people who have recognized repeat player status can apparently get better deals than first time players, so they are increasingly able to act as agents for others who want to trade only one time. Furthermore, mechanisms have developed to facilitate trust building. A buyer can post a comment on the transaction once it is completed, for instance, and a negative posting is likely to be devastating. Arrangements can also be made for a trusted third party to hold a payment until a satisfactory delivery has been made.

When two strangers initiate trade in an emerging market, the typical process involves several small steps rather than an immediate large commitment. The two strangers will start by attempting to gather information about the potential trading partner, and if nothing negative is discovered, they will make a small trade. If that is successful, additional trades occur and they can get larger, but substantial commitments will not occur until a strong trust relationship develops [e.g., see McMillan and Woodruff (1998)]. This can take some time, so the payoff to investments in establishing such relationships are delayed and very uncertain, making the incentives to make them relatively weak and suggesting that the emergence of commerce based on such sources of trust may be slow. Promises can be made relatively credible if the promisee has recourse, however, just as a promisor who reneges can be sanctioned. In other words,

recourse is a substitute for trust (and trust is a substitute for knowledge, as noted above).

Emerging law for cyberspace markets

The primary historical source of such recourse for emerging commerce is privately adjudicated (i.e., mediated or arbitrated) and enforced (e.g., through the spread of information about non-cooperative behavior and boycott sanctions) polycentric (e.g., different trade associations and other commercial groups have their own traditions and practices, and often, their own dispute resolution mechanisms and sanctioning processes) customary law (Benson, 1989, 1998c, 1998d). As explained in Benson (1999b, 1999c, 2000b), customary law has numerous advantages over state-made and enforced law. These arguments are not repeated here because they are readily available elsewhere. Instead, the arguments made regarding law for emerging markets in geographic space made in Benson (1999b) are simply shown to be relevant for emerging markets in cyberspace too.

While many observers contend that the state must step in to provide commercial law for emerging cyberspace markets, there are a number of reasons to do precisely the opposite. First, states are probably not capable of establishing order and the rule of law in cyberspace. After all, the best analogy to compare the evolving internet market to is probably not the commercial arrangements that developed within any particular geographically bounded nation like the United States. Internet commerce is not likely to be constrained by such boundaries. It will be international in scope, so there really is no state government that will be in a position to rule over it. In this regard, it took privately produced and adjudicated medieval *lex mercatoria* to overcome the limitations of political boundaries and localized protectionism during the medieval period, thus paving the way for the commercial revolution and development of international trade (Benson, 1989, 1998d). Furthermore, modern international trade is similarly governed by the modern *lex mercatoria* (De Ly, 1992: 1; Benson, 1998d, 1999b, 1999c, 2000b). Territorial governments typically cannot provide appropriate law for such trade because of the artificial constraints of geographic boundaries (a customary legal

system's jurisdiction may reflect a functional rather than a geographical boundary). In fact, there is no reason to believe that any particular national government is of the ideal size to take full advantage of the economies of standardization in law. However, since customary law can be geographically extensive and functionally decentralized (i.e., specialized), in contrast to the law of geographically defined states that tends to be functionally centralized and geographically constrained, customary law can have different sized

jurisdictions for different functions. For cyberspace commerce, the economies of standardization in law appear to be greater in geographic scope than any existing nation can encompass, along with being narrower in functional scope. International cyber trading groups are likely to be the most efficient source of rules and governanceCjust as international trade associations and commercial organizations are for international geographic trade. A system of polycentric customary law is much more likely to generate efficient sized Ajurisdictions@ for the various legal communities involved in cyberspace trade encompassing many of today's political jurisdictions.

Second, even if they are capable of doing so, the fact is that the beliefs and/or objectives of those with authority in many states are generally not compatible with the kinds of law that will effectively support a strong market economy in cyberspace. Indeed, the rapid expansion of unregulated and untaxed activity in cyberspace is increasingly seen as a threat to state power, and a fundamental purpose of cyberspace law emanating through state legislation is likely to be shaped by concerns for preserving the political system. This is likely to be in direct conflict with the effort to create a cyber-market system. Preserving the state's ability to regulate and tax may be desired in order to pursue various Apublic virtues@ as defined by their advocates, like the suppression of pornography, prevention of trade in illegal commodities or information, or the prevention of fraud, but for many people involved, the reasons are much more selfinterested as they seek wealth transfers or the protection of rents that are threatened by emerging

competition from internet commerce.⁴ The fact is then an understanding of law requires recognition of the conflict between incentives to use the legal system to pursue wealth through both productive and transfer processes (Benson, 1999a). As emphasized in Benson (1999b, 1999c, 2000b), unlike voluntary joint production and exchange that tends to increase wealth, involuntary wealth transfers through enforcement of legislated rules tend to reduce trade and wealth creation for at least four reasons:

(1) A transfer (e.g., through a tax and/or subsidy, or through granting of a monopoly franchise) produces a deadweight loss.

(2) As Tullock (1967) explains, the resources consumed in the competition for such transfers also have opportunity costs which can be very large since individuals and groups have incentives to invest time and resources in an effort to gain wealth through the political process.

(3) Victims of the transfer process have incentives to defend their property rights, partly through rent-avoidance costs associated with investments in political information and influence, and partly through exit, whether by moving to an alternative legal jurisdiction, or by hiding economic activity and wealth (e.g., moving transactions

⁴Motivations might be more sinister as well. Through corruption of public officials, for instance, organized crime can often gain a monopoly over geographically constrained black markets (Benson, 199b, 2000b), but the development of a cyber market can undermine such geographic monopolies, and therefore undermine the incentives for corrupt state officials to maintain the array of licenses, permits, fee requirements, import/export procedures, and high taxes that stimulate black market trade and create the opportunities for corruption. On the other hand, imposing rules on the internet creates opportunities for more income from corruption.

Underground into black markets which generally have their own customary rules and enforcement mechanisms⁵). In order to induce

⁵These informal sectors are also examples of customary law communities. They arise because individuals also have incentives to move cooperative efforts underground in order to produce wealth that cannot be taxed or transferred, or to produce wealth through activities that the state attempts to prevent. The fact that such activities must avoid detection and/or measurement will tend to alter their characteristics relative to the above ground trade associations and other commercial groups discussed here, however. As Taylor (1982: 65) notes, the basic cooperative means of maintaining social order still exist, even in the most modern system of centralized authoritarian rule, although they may exist in atrophied and attenuated forms. Numerous examples of centralized coercive systems can be cited where parallel predominately cooperative systems of norms and institutions actually dominate many and at times even most interactions (e.g., de Soto 1989; Ellickson, 1991). De Soto's (1989) detailed analysis of the informal sector in Peru is particularly revealing in this regard, as he explains that the squatter communities are very well organized, that members respect each other's property claims, cooperate to enforce rules of behavior, and so on. Nonetheless, the existence of a coercive ruler raises transactions costs for such groups. For instance, these groups' efforts to enforce their own rules may require tactics that violate the state's law. Ostracism is less effective when property rights are tenuous due to the threat posed by the state for instance, making some horizons short which, in turn, means that repeated-dealing arrangements and reputations are less valuable. If tit-for-tat and reputation sanctions are relatively ineffective, the victim of a breach may be forced to opt for retribution. Customary law communities may still aid the victim in the illegal vigilante exaction of retribution, of course. Under such circumstances, a considerable amount of crime may be undertaken to exercise social control (Ellickson, 1991: 213; also see Benson (1998f), and de Soto (1989). The result need not be violent: it could involve the seizure of an asset, for instance. However, this may not be an attractive option because such a seizure might be treated as a theft by the political authority. Thus retribution may take the form of destruction of an asset (vandalism) belonging to an offender, which is likely to be easier to cover up than a seizure (Ellickson, 1991: 217), or even physical punishment (assault). Merchant communities can be forced underground, too, of course. As European governments attempted to establish control over maritime trade in order to tax it, and granted franchises for numerous trading monopolies between 1500 and 1800, for instance, the average merchant and seaman responded with smuggling, and a substantial part of maritime commerce was carried out in violation of the laws of some nation-state (Rosenberg and Bridzell, 1986: 92-96). Furthermore, the middle and even the upper classes willingly wore, drank, and ate smuggled goods

compliance with discriminatory transfer rules, the rule makers will generally have to rely on an enforcement bureaucracy, both to prevent exit (e.g., establish a monopoly in law) and to execute the rules.⁶

(4) Faced with the probability of involuntary transfers, productive individuals' property rights to their resources, wealth, and income flow are perceived to be relatively insecure, so their incentives to invest in maintenance of and improvements to their assets, and their incentives to earn income and produce new wealth that might be appropriated, are relatively weak.

Government efforts to influence and control commerce tend to slow such developments rather than speed them up. After all, when property rights are insecure due to the potential arbitrary and/or opportunistic behavior by government (e.g., changes in tax policy to capture the quasi-rents that arise with investments in reputation), incentives to invest in reputation or to count on future dealings are weak and the kinds of private sanctions discussed here are likely to be relatively weak. The ability to develop and then choose a customary law jurisdiction may be relatively weak too. As Pejovich (1995: 17) notes:

(Rosenberg and Birdzell, 1986: 93). Indeed, many smugglers were highly respected members of merchant communities, as well as their geographically localized communities (e.g., John Hancock). Such communities may also have to modify their dispute resolution and sanctioning institutions relative to the arrangements examined in Section I above.

⁶Even rules that facilitate voluntary production and exchange (e.g., private property rights) require some enforcement costs, of course, but the level of these costs increases dramatically when laws are also imposed in order to generate involuntary wealth transfers.

AThe arbitrary state undermines the stability and credibility of institutions, reduces their ability to predict the behavior of interacting individuals, raises the cost of activities that have long-run consequences, and creates conflicts with the prevailing informal [customary] rules.@

Third, while the entire internet market may not be supported by recourse (e.g., arbitration, effective ostracism sanctions) yet, the fact is that strong market economies in geographic space did not have them either until they became desirable (Benson, 1989, 1998d). The evolution of the private institutions of commercial law and of market institutions themselves has always been simultaneous rather than sequential (Benson, 1989). As the conditions of commerce change, customary rules and non-state governance institutions evolve, and this in turn leads to more commercial developments and more legal evolution. In fact, arbitration services are being offered on the internet now [simply choose a search engine and search for Aarbitration@], and their availability should expand as internet traders move beyond small transactions and those for which trust arises in the context of repeated deal relationships or reputation (an issue addressed in more detail below). Reliance on the state for rules and/or legal sanctions at this early stage of market development on the internet may mean that the future evolution commercial law will be along a very different path than the one taken in the strong market economies of Western Europe and North America. Indeed, if we look to these economies for models of how market economies emerge, then we must recognize that markets were well established and governed by customary law long before the states got involved in the making and enforcing of rules of commerce, and that even when the states did so, they generally started by recognizing established custom (Benson, 1989, 1998d). Furthermore, in many places the institutions of customary law (merchant courts, arbitration) have survived as an ongoing source of competition for the state, helping to constrain its activities. In law, as in markets, competition is an important determinant of the outcome. Competition enhances abilities to evaluate and choose among rules, stimulates legal

innovation and sophistication (Berman, 1983: 10), and limits the potential for using law as a transfer mechanism and reducing the potential for wealth creation.⁷ Finally, and perhaps most significantly, the vast potential of cyberspace will remain untapped if the rule of law does not develop, but this means that these cyber merchants have tremendous incentives to establish their own law. International merchants have found ways to govern their activities for centuries,

⁷There may be efficiency reasons for wealth transfers, of course. Some individuals inevitably fall on hard times, for instance, whether through ineptitude or bad luck, and these individuals may feel compelled to take wealth from others in order to survive. The potential for such occurrences make property rights relatively insecure, so a cooperative group may establish mutual insurance arrangements that transfer wealth to such people in order to encourage them to continue to recognize the cooperatively-produced rights system even when circumstances change for the worse. That is, apparent altruistic behavior in the form of voluntary wealth transfers can be made by rational self-interested individuals in order to induce others who find themselves in distress to continue to behave in predictable ways over the long term (Johnsen, 1986), and therefore, it should not be surprising to find that polycentric customary law systems often support substantial levels of voluntary transfers, frequently as part of mutual insurance arrangements. Voluntary wealth transfers can also be a means by which entrepreneurial individuals gain prestige, and therefore, expand their potential for trade and other forms of wealth-enhancing interactions (Benson, 1999a). As Ridley (1996; 138) puts it, such acts "scream out 'I am an altruist; trust me.'" Not surprisingly, gift exchanges and spot-latching are common practices in customary law communities throughout history all over the world (Ridley, 1996: 114-124), including commercial communities (Benson, 1999a). Thus, for instance, Wesson (1978: 160) explains that in the Italian merchants of the 13th to the 15th centuries gave generously to public projects such as universities and cathedrals (Wesson, 1978: 162-163). Similarly, in the 17th century, "no other people provided as amply for their poor as the mercantile Dutch" (Wesson, 1978:173). The same was true of England of the 18th century, where merchants "seeking security for property and person, freedom to produce and enjoy wealth," they were generally characterized as "generous, sober, and charitable" (Wesson, 1978: 197, 199). The fact that wealth transfers can enhance efficiency, and that voluntary wealth transfers are widely practiced does not imply that the use of coercive law to induce involuntary transfers will also enhance efficiency, however (Benson, 1999a). In such cases, interest group politics and rent seeking tends to dominate, as explained below, so a substantial part of the wealth transferred tends to go to those with political power rather than to those who find themselves to be destitute. Thus, government failure is likely to undermine any efficiency gains.

and cyber merchants will do the same. We are already seeing private quality rating services (America Online's Certified Merchants program, the CPA Web-Trust seal) investments in non-salvageable assets (e.g., expensive television advertising), reputations mechanisms being established (e.g., the ability for buyers to comment on transactions made on AE-Bay, firms with reputation in non-cyber markets such as stock brokerage firms) and repeated dealing relationships being formed (e.g., many AE-Bay@ traders are repeat players). Indeed, while this technology does allow people to interact anonymously, it also allows people to spread information very quickly and cheaply, so reputations can be built and destroyed with relative ease. Informal trading groups are already developing and formal organizations will soon follow, if they have not already. Membership in such groups will serve as a bond, assuring others that the member is reliable, and sanctions against those who prove otherwise will arise. Repeated dealings and reputation effects are being used to support trade among the members of these groups. During the early stages of their formation they may not develop arbitration arrangements, relying instead on negotiation and threatened sanctions to resolve disputes (McMillan and Woodruff, 1998). Arbitration services are being offered over the internet, however, and the fact is that it takes time for the private institutions to evolve. In fact, at least one entrepreneur has already recognized the potential market for both organizational and arbitration services.

James C. Bennett (1998, 1999a, 1999b, 1999c) has established Internet Transactions Transnational, Inc. (ITTI) in order to offer services that will facilitate the rapid development of communities of internet traders (what he describes as Acyberspace clubs@ or Aislands of trust@) within which high-valued transactions between anonymous traders can take place. Indeed, the same characteristics that many see as barriers to the development of trust and/or law, Bennett sees as ideal for the formation of voluntary communities. To him invisibility (e.g., through encryption) allows selectivityCyou deal only with those you want to deal with. Keys and passwords actually provide means of establishing high degrees of assurance of authenticity while permitting easy enforcement as violators can be expelled

instantaneously. Two things appear to be lacking: the ability to determine initially that another party is likely to be trustworthy (non-salvageable assets and/or reputations cannot be observed); and, recourse through a dispute resolution process that will respect and enforce the rules that a club of traders want to be enforced. Therefore, ITTI proposes to create cyberspace clubs by assuring trust with confidentiality, as well as enforceability (recourse). Potential members will be screened to insure that they have no history that would suggest that they are not deserving of trust (real identities would have to be revealed to the screening agent in order to get into a club, but once accepted the member would be able to transact under a different identity insured through encryption and public keys for the trading community). All contracts will contain arbitration clauses with binding arbitration required. Each club will have its own set of rules although ITTI will offer alternative sets of Acovenants@ to clubs that are in their formative stages, if they are desired. Refusal to live up to promises or to accept arbitration would produce automatic expulsion. Arbitration will be facilitated by a Adigital notary@ service that receives copies of agreements, and notarizes and stores them in encrypted files to ensure authenticity. Will such an enterprise work? Only time will tell, but if it does not (and even if it does), some other option will develop. Perhaps monetary bonds held by reputable banks, insurance companies, or firms like ITTI will be required to start such clubs, for instance. But the potential benefits from internet commerce are simply too great for entrepreneurs such as Bennett who want to capture them to allow the lack of trust and recourse to persist.⁸ Thus, the real threat to the evolution of cyber markets is that various national governments and international organizations of governments will step in to establish order, thereby undermining the development of a market order supported by a polycentric system of customary law christened by Bennett (1998) as *Lex Cybermatoria*. The withdrawal of the state from any efforts to influence commerce in cyberspace is likely to do more to stimulate

⁸Several other innovative uses of technology and institutions are envisioned for ITTI. For details see Bennett (1999a, 1999b, 1999c).

commercial activity than any proactive efforts by the state. Laissez faire appears to be the best policy for emerging economies in the area of arbitration and contract law enforcement as well as in economic policy itself (Benson, 1999b, 1999c, 2000b).

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