Social Norms, Culture and Better Regulation

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Oikeuspoliittinen tutkimuslaitos

2010

Juurikkala , O 2010 , Social Norms, Culture and Better Regulation . in J Tala & A Pakarinen (eds) , Better Regulation - A Critical Assessment : Proceedings from the International Conference on Legislative Studies in Helsinki 2010 . National Research Institute of Legal Policy Research Communications , no. 105 , Oikeuspoliittinen tutkimuslaitos , Helsinki , pp. 3-26 , International Conference on Legislative Studies , Helsinki , Finland , 01/03/2010 . < http://hdl.handle.net/10138/152509 >

http://hdl.handle.net/10138/323854

NATIONAL RESEARCH
INSTITUTE OF LEGAL POLICY
RESEARCH COMMUNICATIONS
105

Better Regulation – A Critical Assessment

Proceedings from the International Conference on Legislative Studies in Helsinki 2010

Jyrki Tala & Auri Pakarinen (eds.)

National Research Institute of Legal Policy
Research Communications 105

Oikeuspoliittisen tutkimuslaitoksen tutkimustiedonantoja.
Rättspolitiska forskningsinstitutet. Forskningsmeddelanden.

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BETTER REGULATION – A CRITICAL ASSESSMENT

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Legislative Studies in Helsinki 2010

Helsinki 2010

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SOCIAL NORMS, CULTURE AND BETTER REGULATION

Oskari Juurikkala[*]

Introduction

The starting point of this paper is twofold. Firstly, *theories of regulation*[1] *imply theories of man and society:* what human persons are; how they choose and behave; how they interact with each other; why and when they obey laws, and so on. Secondly, there is *nothing more useful than a good theory*. A good theory is one that is sufficiently simple, so that it can be used in practice, and sufficiently realistic, so that it does not significantly depart from the truth.[2]

One of the most successful theoretical frameworks in regulatory literature has been *law and economics*, which combines legal and economic analysis. It is a useful approach, because it is both quite simple and quite realistic. It is not my intention to do away with it, but I will argue that it can and should be improved. There are two improvements that seem especially pertinent.

One is to challenge 'legal centralism' and to adopt a broader understanding of the sources of normativity in human choosing and acting. In other words, we should not limit the analysis to different types of law and their usefulness in regulation. The other is to expand our concept of motivation in human behavior, especially taking into such notions as moral character and culture. In what follows, I will firstly explain these ideas in more detail and then suggest implications for regulatory discussion.

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[*] I am grateful for comments to Kati Rantala, Pia Letto-Vanamo, Martti Vihanto, Matias Forss, Jason Lepojärvi, and conference participants at the International Conference on Legislative Studies in Helsinki, 1–2 March 2010.

[1] I am using the word regulation in a broad sense that covers both 'regulatory law' properly speaking and other kinds of deliberate state influence, ranging from general legal rules to specific intervention by regulatory bodies. I do however distinguish it from other (non-state) forms of social control or influence. See Baldwin and Cave (1999: chapter 1) for different definitions of the concept of regulation.

[2] This is obviously a simplistic summary of very complex set of issues.

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Social and Behavioral Theory: Two Proposals

Against Legal Centralism

My first objective is to challenge the legal centralism that is implicit in most law-and-economics and regulatory theory and debate. It is assumed that law is what matters: simply put, when there is a problem, we probably need a new law. This assumption is not often said explicitly, but it is implicit in the logic of most legislative and regulatory projects. Certainly, legislators and regulators are increasingly aware of the *limits of legislation and regulation:* they realize that law cannot do everything. But then again, that is often where the analysis stops.

Yet much more can be said about it – and has been said. The French aristocrat, Alexis de Tocqueville once mused in his observations on the democratic experiment of the United States: 'Laws are always unsteady when unsupported by mores; mores are the only tough and durable power in a nation' (Tocqueville 1969: 274).

More recently, we have seen a burgeoning literature on the roles of and relationships between law, social norms, private morality, culture etc. Contributors to this discussion include several recipients of the Nobel Prize in economics. Ronald Coase (1991), for example, has frequently argued for the importance of studying the economic system empirically, especially in light of the *richness of institutional arrangements*. Drawing on evidence from economic history, Douglass North (1990) has studied the roles of *formal and informal institutions* in economic development. In her empirical work on the governance of common-pool resources, Elinor Ostrom (1990) has demonstrated the complexity and fundamental importance of *non-state governance*. Oliver Williamson (2000) has also underlined the role of non-state governance institutions in the transition from socialism to a market economy.

Among experts of regulation, Ayres and Braithwaite (1992: 12–14) could especially be mentioned for their stress on the role of communities and associations in understanding the institutional order of a society. And in law-and-economics literature, we have seen wide-ranging discussions on the roles and interactions between law and social norms.[3] In the next section I will highlight some interesting findings of this discussion and then draw out implications for regulation.

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[3] Mercuro and Medema (2006: chapter 7) provide a good overview of the literature.

Law and Social Norms

The perspective here is not simply that there are limits to legislation. It is that law, social norms, culture, morality and so on are *parts of a complex whole* that should be analyzed as such. The argument for a more holistic perspective is that, firstly, *it is more realistic*, and secondly, *it is possible*. Although 'social norms' is a vague concept, it can be studied both theoretically and empirically.[4] In broad terms, both social norms and law can be seen as sources of normativity for human choosing and acting – sources which may be complementary or conflicting, supportive or eroding.

Social norms and law relate to and interact with each other in various ways (see Panther, 2000). On the one hand, law and social norms may *complement* each other, as is perhaps often the case without our even noticing it. Social norms provide the broad institutional environment within which legal norms and formal institutions function and operate. The central importance of these *supportive social norms* is usually only appreciated when they begin to be eroded. The supportive function may also manifest itself the other way around: enshrining pre-existing social norms into law will give them greater strength and importance – perhaps even if such laws are difficult to enforce.[5]

On the other hand, law may come into *conflict* with social norms. In such setting there are several possible scenarios. (i) It may be that, over time, *social norms adapt to legal rules*. This is likely to happen when such adaptation does not imply a loss on any significant party. But it may also be argued that generally law tends to shape social norms through its 'expressive function' (Sunstein, 1996a, Cooter, 2000).[6] (ii) *Legal rules may adapt to social norms*. In broad terms this happens often through legal reform, given that social norms are among the main factors that influence legal and social change.[7] But it may also happen that 'law in the books' is

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[4] See Juurikkala (2009) for a review of the literature in the context of commercial relationships.

[5] Cooter (2000) gives an amusing example. A new law in California required dog-walkers to clean up the poop. Before that, most people thought that was the right thing to do anyway, yet people did not complain much about dog poop; now after the new law, they do complain if someone breaks the law. It is easier to say 'obey the law' than 'don't be so rude'. When a standard of behavior is included in the legal code, it has the moral backing of the legitimate public authorities of the community.

[6] For example, laws relating to environmental protection, tobacco smoking or drug use can have a powerful effect on public perceptions and expectations.

[7] An interesting historical example, among many others, is the formation of the Western legal concepts of criminal culpability, which emphasizes subjective intention instead to the objectivism of earlier Germanic practice; this notion of culpability was simply rooted in Christian moral theology (Berman, 1983).

supplanted by 'law in action' that reflects entrenched social norms in opposition to the literal meaning of the law. (iii) *The two may also influence each other*, one dominating from time to time and in different contexts.

Some social and legal theorists have emphasized the importance of social norms as the proper basis of legal norms.[8] Cooter (1996) argues that English contract law was rooted in the traditional 'law merchant' (*lex mercatoria*), which was based on business customs and cooperative dispute resolution mechanisms. As the power of English common law judges grew, they began to deal with commercial disputes; but instead of trying to create a new set of rules, they sought to discover the rules already in existence among merchants, and to enforce those rules selectively so as to create a coherent and systematic body of rules.

However, placing too much emphasis on law may have an *adverse effect on social norms*. Pildes (1996) has warned about the possibility of destroying valuable social norms through law. Various fundamental social virtues, such as reciprocity, are learnt and acquired not through law but through life in smaller communities such as families, clubs and churches (see Tocqueville, 1969). Such social norms as reciprocity can be undermined through law-making and public policy by destroying the social conditions that enable informal reciprocity. For example, urban planning, when it pays little attention to the social context, may remove the practical opportunities for exercising reciprocity and maintaining active community life; thus the transition from busy street interaction to empty and quiet places may, paradoxically, have lead to the creation of more dangerous neighborhoods (see Jacobs, 1961). Similarly, overambitious welfare policies may crowd out pre-existing local-level and voluntary institutions that provide informal but effective remedies in unemployment, illness and old age (Beito, 2000, Putnam, 2000, Juurikkala, 2007).[9] It may therefore be

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[8] Earlier contributions include Hayek (1960, 1973) and Leoni (1991).

[9] Beito (2000) is an insightful historical investigation of how so-called fraternal societies in the late nineteenth and early twentieth centuries provided extensive assistance ranging from health insurance, support in unemployment, orphanages, and homes for the elderly. Similar institutions existed in many European countries. Beito argues that such institutions died out not because they were deficient but because governments took over their role with taxpayer money, yet something important was lost in the transition. This dilemma of the welfare state has been subject to substantial discussion recently, especially in what is known as the social teaching of the Catholic Church. John Paul II (1991: 48) famously wrote that 'excesses and abuses, especially in recent years, have provoked very harsh criticisms of the Welfare State, dubbed the "Social Assistance State". Malfunctions and defects in the Social Assistance State are the result of an inadequate understanding of the tasks proper to the State. Here again the principle of subsidiarity must be respected: a community of a higher order should not interfere in the

that sometimes law should simply provide a good, broad institutional context, but avoid unwise *over-judicialization* of society, as that may have complex and negative long-term consequences.

One of the central insights of the social-norms perspective is that both law and social norms have their proper role and scope. Even when they support each other, they operate very differently. For example, Bernstein (1996) observes that there are many reasons why parties to a commercial transaction may actually prefer some aspects of their agreements and relationships to be *legally unenforceable*. Negotiating remote contingencies may signal distrust or unusual desire to litigate, and overly detailed contracts may make things too inflexible if circumstances change; legal system costs (litigation costs, delays, risk of judicial error) are high and both parties may prefer to avoid the possibility of legal battles; and there are many factors that are known to the parties by not verifiable by in a legally enforceable way. One common strategy seems to be that commercial transactors govern their dealings through flexible, cooperative social norms when they have a mutually beneficial, long-term relationship; but they combine those norms with legally stricter contracts that can be invoked if the other party turns out to be untrustworthy.

This sensitivity to social context is reflected in some traditional legal principles such as the English doctrine that, when it comes to agreements of a domestic nature, there is a rebuttable presumption that the parties did not intend to create legal relations. The wisdom of this principle is that legal battles tend to shatter relationships, and strictly legal rights and duties cannot contain the rich and complex notions of justice and reasonableness that parties to a personal and long-term relationship have. As Lord Justice Atkin famously put it:

> ‘The common law does not regulate the form of agreements between spouses. Their promises are not sealed with seals and sealing wax. The consideration that really obtains for them is that natural love and affection which counts for so little in these cold Courts. The terms may be repudiated, varied or renewed as performance

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internal life of a community of a lower order, depriving the latter of its functions, but rather should support it in case of need and help to coordinate its activity with the activities of the rest of society, always with a view to the common good. […] In fact, it would appear that needs are best understood and satisfied by people who are closest to them and who act as neighbours to those in need. It should be added that certain kinds of demands often call for a response which is not simply material but which is capable of perceiving the deeper human need. One thinks of the condition of refugees, immigrants, the elderly, the sick, and all those in circumstances which call for assistance, such as drug abusers: all these people can be helped effectively only by those who offer them genuine fraternal support, in addition to the necessary care.’

> proceeds or as disagreements develop, and the principles of the common law as to exoneration and discharge and accord and satisfaction are such as find no place in the domestic code.'[10]

Greater sensitivity to the relationship between law and social norms also enables us better to understand legal – and regulatory – practices in *different cultures and societies*. Each culture is a product of numerous factors working over centuries and millennia. Western legal culture cannot be properly understood without taking into account the complex 'synthesis of Athens, Jerusalem, and Rome' (Gregg, 2003: xiv) that gave rise to Western civilization. In such places as Africa, India or China, the history and the accompanying social norms are very different indeed. Winn (1994), for example, argues that in the context of non-Western countries like China, it is appropriate to speak of *legal marginalism*, because Chinese relational systems give more importance to elaborate notions of reciprocity and trustworthiness.

Last but not least, social norms can be enforced through various *non-legal sanctions*, which in some respects resemble legal sanctions but in other respects are quite different (Panther, 2000, Charny, 1990). On the one hand there are *external sanctions* of two types, (i) *second-party control* and (ii) *third-party control*. Second-party control refers to non-legal sanctions that may be used by the other party to the transaction, such as refusing to do business again or creating credible threats (Williamson, 1983). Third-party control requires the cooperation of third parties, for example in the form of gossiping, shaming, and loss of reputation. Then there is also a third type of non-legal sanction, namely (iii) *internal sanctions* (which may also be called *first-party sanctions*). They are various emotional reactions that human beings may have as a result of following or breaking social norms. On the positive side, they include such emotions as empathy, human desire for approval, honor and esteem. On the negative side, one may experience regret, remorse, shame, guilt and embarrassment. Frank (1987, 1988) proposes that the ability to undergo such emotional reactions is valuable, because it supports the establishment of mutually beneficial, cooperative relationships.

The idea here is not simply that social norms can be enforced too, but that legal and non-legal sanctions are different yet related to each other. For example, Cooter (2000) notes that, although legal enforcement of rights and duties is often necessary, it also tends to be expensive, time-consuming and uncertain. Therefore it is important that laws be

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[10] Balfour v Balfour [1919] 2 KB 571, at 579–580.

complemented by social norms which support reasonable behavior. On the other hand, Pildes (1996) argues that over-intrusive laws can destroy social capital by failing to see the differences between enforcing social norms and enforcing laws. Social norms are not substantive rules, but they are *dynamic wholes* which are tied to complex social structures and flexible enforcement mechanisms. The informal enforcement of social norms differs drastically from formal legal processes, and the remedies available for breach of social norms are flexible and subtle, something that is rarely the case with law. This is a reason to respect the proper realm of social norms.

Incentives, Motivation and Moral Behavior

I have tried to show that the legal centralism of much of regulatory debate is neither necessary nor fruitful, because better results can be obtained by looking at a broader scope of sources of normativity. My second objective is to show that we can and should do the same about our understanding of human motivation and morality. In fact, these two perspectives are closely related: for example, the notion of 'non-legal sanctions' necessarily takes us to the issue of *moral or internal constraints* on action. However, the motivational and ethical perspective on behavior goes beyond such constraints.[11]

Douglass North (1990) once said that *internal norms* are crucial to our understanding of social institutions, but we do not have any good theory of them. I agree with the first part, but I disagree with the second. We do have several good theories of human choice from an internal perspective, and even the disagreement between some of the accounts may only be apparent. In this paper I cannot delve into specific debates, but I will highlight some perspectives that are empirically strong and that support each other.

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[11] Mitchell (1999: 208–209) has criticized the new '[social] norms jurisprudence' for accepting too much of the behavioral and positivistic attitude of modern social science and economics: the approach may end up distorting instead of improving the explanation of norms, because the leading authors 'generally share the same basic goal, which is to establish a non-normative theory of norms. [...] They tend to share an underlying metanorm of efficient wealth or welfare maximization, and all share the basic belief that people are motivated principally – if not solely – by self-interest. Most importantly, by limiting their inquiry to what they see, they are unable to explain, except at the most superficial level, how norms become normative – that is, how they come to tell us what we ought (or ought not) to do.'

Intrinsic motivation. It is obvious that people do many things not because they get some external benefit from it but because is an immediate source of human fulfillment (see Staw, 1976, Deci and Flaste, 1995, Frey, 1997). Children need not be paid to play, and even few adults work only for the money (this is especially true of some professions, notably academic research). Similarly, most people devote time and energy to different forms of friendship and community – especially marriage and the family – not only because of some external benefits but mainly because friendship itself is an important aspect of truly human life.

Nevertheless, mainstream economic models of human behavior tend to ignore the relevance of intrinsic reasons for action, because they treat human motivation as a 'black box'. The problem is that this leads to too much importance being given to external compensation or punishment. Many empirical studies have shown that external incentives – sticks and carrots – do not always produce the desired results, because external interventions interact with intrinsic motivations in complex ways (Frey 1993, Kohn, 1993). Building on a wealth of psychological literature, Frey (1997) summarizes the relationships between intrinsic and extrinsic motivation as follows:

(i) Intrinsic motivation is of great importance for all human activities; it is inconceivable that people are motivated solely or even mainly by external incentives.

(ii) The use of monetary incentives crowds out intrinsic motivation under identifiable and relevant conditions (*Crowding-Out Effect*). The same may also be true of other external interventions such as commands or regulations.

(iii) External interventions may, on the other hand, enhance intrinsic motivation under some conditions (*Crowding-In Effect*).

(iv) Changes in intrinsic motivation may spill over to areas not directly affected by monetary incentives or regulations (*Spill-Over Effect*).

For example, when a child is paid for doing household chores, she is unlikely to contribute without compensation (crowding-out effect). Yet if her father gives her a surprise present as she has been helpful in the house, it is likely to reinforce her intrinsic willingness to help out (crowding-in effect). As a general rule, when external intervention is perceived as *controlling* or *failing to recognize* the intrinsic value of a non-instrumental relationship, it crowds out intrinsic motivation. On the other hand, when it is perceived as *supportive*, self-esteem is fostered and people feel they are

encouraged to act with self-determination. As will be seen shortly, these considerations have great relevance for better regulation.

Fairness and moral emotions. The theory of intrinsic motivation shows that rational self-interest cannot be reduced to external interests and benefits. Evidence on altruistic behavior goes further away from the narrow concept of rationality found in mainstream economic models: ordinary people often act in other-regarding ways even at the a substantial cost to themselves (see Frank, 1988). However, fairness-based behavior is usually complex and dynamic. According to Rabin (1993), the empirical evidence can be summarized in three simple principles:

(a) People are willing to sacrifice their own material well-being especially *to help those who are being kind*.[12]
(b) People are willing to sacrifice their own material well-being *to punish those who are being unkind.*
(c) Both motivation (a) and (b) have a greater effect on behavior as the material cost of sacrificing becomes smaller.

In other words, most people care about fairness in two ways. On the one hand, they want to treat others fairly, treating them well especially when they have received good treatment. On the other hand, people tend to retaliate against those who have treated them badly. But importantly, the extent of fairness-based behavior nevertheless varies according to various criteria, such as reputation effects, amount of material loss, standards of fairness, and self-image.

Moral character. Yet moral behavior is not a question of emotions alone. Already the ancient Greeks thought that human persons can become morally better or worse, according to their education and their own free choices. Aristotle's *Nicomachean Ethics* is a systematic exposition of such *virtue ethics*, which sees good moral character as the result of good habits, i.e. internal capabilities of acting justly, wisely, honestly, maturely etc. Through a consistent attempt to use one's reason, to give each person their due, to overcome internal inertia, and to channel one's various desires according to reason, one develops the cardinal virtues of prudence, justice, fortitude and temperance – habits which in turn make it easier for that person to do the right thing in concrete situations.[13]

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[12] This is not to deny that people can act altruistically regardless of how the others behave; one thinks of all kinds of voluntary workers. However, that probably requires stronger internal commitment to help others, and also the positive response of those being helped is likely to reinforce one's willingness to make sacrifices for them.
[13] For a modern exposition of virtue ethics, see Pieper (1966).

It cannot be denied that the moral character of persons and citizens is fundamental for the well-being of communities and nations. If all men and women are just and reasonable, law has merely a marginal and supportive role to play. Yet if everyone is cruel, selfish, dishonest and irrational, there is no legal and regulatory solution in the world to deal with all the resulting social problems. Indeed, it can be argued that the optimal extent and manner of law and regulation greatly depends on the moral character of the relevant people (see George, 1993).

Strategies for Better Regulation

In this section I outline some implications of these perspectives for better regulation. They have been divided into three categories. First, there are *alignment strategies*, i.e. regulatory approaches that seek to align law and regulation with supportive social norms and intrinsic motivations. The second category is entitled *culture-building and habit-formation strategies*, which focus on influencing social norms for the better and helping persons to adopt good habits. Thirdly, *enforcement strategies* seek to replace or combine legal and formal enforcement with informal enforcement through internal constraints and other non-legal sanctions.

Alignment Strategies

There are various possibilities for aligning laws and regulations with positive social norms and intrinsic motivations. Here are some general guidelines and examples.

Align regulation with positive social norms. Broadly speaking, positive social norms are those that are constructive, cooperative, pro-social etc. When such norms are strong in the relevant regulatory context, the most effective strategy is likely to one that builds upon and reinforces those norms. Generally, it is likely that in such situations there is no need for heavy, top-down regulation, because a *light-touch, grass-roots approach* will be sufficient, less costly and more effective. This is one reason why some form of self-regulation may be advisable (see generally Ogus, 2000). This is not to say that self-regulation is the right solution to all situations, for reasons discussed later in more detail. The point is that when there are positive, pre-existing social norms, giving them a semi-formal regulatory status through self- or co-regulatory schemes is likely to *reinforce* those norms – and to suppress less positive social norms and attitudes.

Avoid law and regulation that corrodes valuable social norms. An interesting example in this respect is the effect of intellectual property rights (IPR) on social norms in research communities (see Menell, 2000: 144). Although it is generally agreed that some form of intervention may be necessary to provide incentives for research and development, it has been argued that IPR may undermine progress in science by promoting values that conflict with the traditional norms of collaboration, disinterestedness and the emphasis on path-breaking basic discoveries (Merton, 1973). The adverse effect of IPR may be especially strong in biomedical research, which traditionally has favored the sharing of research to promote progress and serve humanity (Eisenberg, 1987). There is no simple solution to this dilemma, but such proposals as compulsory licensing may be worth consideration – not only for economic efficiency, but also to foster a cooperative culture of research.

It is interesting to note that in countries such as the UK, law reform proposals have began to given significant weight to surveys on public opinion (which closely relates to social norms).[14] In light of the present paper this is a step forward, because more precise knowledge of public attitudes is vital to the design of good rules. It is however important to understand that public opinion should not be seen as an automatic source of legal normativity, because public attitudes may be poorly founded or incoherent, and social norms may also be manifestly negative and harmful, as is discussed shortly in more detail.

Support positive intrinsic motivation; avoid creating a 'culture of minimal compliance'. The theory of intrinsic motivation gives additional support to light-touch regulation in certain circumstances. Over-intrusive and formalistic regulatory approaches signal mistrust and confrontational attitudes, which are likely to weaken intrinsic motivation to do what is right. If regulatory subjects feel they are being treated mistrustfully and unfairly, they will also tend to respond with spiteful behavior, even to the point of making the job of regulatory authorities as difficult as possible just to 'get even' (see Bardach and Kagan, 1982). In the worse case, the regulators will in response feel their authority being undermined, and will retaliate with even worse treatment, giving rise to a spiral of hostility.

Frey (1997) advises that positive intrinsic motivation is reinforced by external intervention that is perceived as supportive. This perception can be fostered numerous ways. One way is to develop *personal relationships* between regulators and regulatees. Another is to give the regulatees a sense of autonomy and to provide *participation opportunities*; self- and co-

[14] See for example Law Commission (2006: 1.21, 5.74-77, 5.84, 7.12-17, 7.47).

regulation are clear instances of such participation, but one can think of many other possibilities too. Thirdly, the message implied by external intervention is important; for example, *rewards* may be more fruitful in some contexts than punishments and commands.

It will also be better at times to rely on *soft, non-enforceable directives* implemented by agreement instead of hard rules backed up by harsh sanctions. Building on evidence from health and safety regulation, Bardach and Kagan (1982) argue that hard regulation tends to cause crowding-out of intrinsic motivation among the better manager, who otherwise would have gone beyond the regulations. A similar argument could probably be made about environmental regulation, where too much emphasis on prices and regulations may actually have an adverse effect on intrinsic motivations to be pro-environment; the consequences will be even worse if hard regulations are poorly designed.

It is obvious that tough sanctions are sometimes needed. However, Ayres and Braithwaite (1992) argue that regulation should always start with a persuasive approach, and it should provide differentiated treatment for the 'good guys' (those who comply voluntarily) and the 'bad guys' (those prone to cheating). Punishing misbehavior is also important for the intrinsic motivation of others, because they will otherwise feel that the rules are unfair and there is a 'law of the jungle' in place.

Use broad, flexible standards instead of detailed rules. In alignment strategies, flexible and principles-based standards are likely to work better than narrow, detailed rules. The reason is simple: broad standards are similar in kind to social norms – and indeed moral principles – because they focus more on fairness and reasonableness than on formal rights and duties. They are also more flexible and adaptive, which is why many authors claim that they are the best approach in rapidly changing environments. For example, UK industrial safety legislation has been criticized for failing to create any substantial reduction in accidents, partly because the laws center too heavily on machinery accidents that are less relevant in today's workplaces, and also because the mandated safety devices fail to take into account broader factors such as the adaptive responses of workers (Veljanovski, 2007).

Once again, the optimal strategy will depend on the details of each case. Strict rules – or at least demanding interpretation of broad standards – may be necessary when there are *strong adverse incentives* to depart from cooperative and pro-social behavior.

Identify the proper role, scope and style of law and regulation. The theory of social norms highlights the difference between social and legal norms: they operate differently, and this means that it is important to give

each a suitable role. In legal and regulatory design, one implication is that we should be conscious and discerning of the relevant social context. In some situations, legal categories and principles cannot adequately reflect the relevant factors that the participants themselves feel should determine the outcome of certain conduct or dispute. Family problems are the most obvious case, but the issue is relevant to all the examples discussed so far.

It is also important to be conscious of and sensitive to *cultural differences*. They are, for example, a fundamental factor when it comes to the success of 'legal transplants' (see generally Watson, 1993). Boettke (1998) argues that one cannot understand differences of economic development without taking into account the role of culture. The twist in Boettke's argument is that on the general level, we know what kinds of institutions are necessary for economic development – institutions such as private property, sound money, and freedom of contract – but we do not know how to implement them successfully: 'Economics may establish the properties of alternative rules, but culture and the imprint of history determine which rules can *stick* in certain environments. The problem is not one of private property and freedom of contract generating perverse consequences, but the fact that some social conventions and customary practices simply do not legitimate these institutions. If market transactions – which are universal – are constrained to a *sub rosa* existence, the commercial life and development will be limited. To move from that *sub rosa* existence, legal-political institutions must be adopted, but such adoption is only possible if there is a cultural fit.' (Boettke, 1998: 13)

A topic example of the role of cultural differences is intellectual property rights (IPR) protection in China. The central government seems to be making an effort to enforce Western-style patents and copyrights, but practices in regional courts and other public bodies can be very different, because Chinese attitudes towards Western rights and privileges are influenced by many factors other than formal legal provisions alone (see Fung, 1996, and Allison and Lin, 1999). The role of culture is also relevant closer to home: the European Union consists of countries with very different histories and cultures, which is one reason why 'one-size-fits-all' solutions may become 'one-size-fits-none' regulations. Thus the social norms perspective cautions us against excessive centralization of regulation in a setting of large cultural differences.

Culture-Building and Habit-Formation Strategies

Foster cooperation by combining fairness with toughness. Most of the time social problems are caused by various kinds of destructive, anti-social and uncooperative habits and norms. Can anything be done to improve the situation? One way of looking at it is that, assuming the issue is important and persuasive regulation does not deliver results, tough sanctions are needed. The general idea here is that when people are not freely willing to act fairly and reasonably, external intervention of some type may be needed. An interesting case to consider is the UK Financial Services Authority (FSA), which has been criticized for having adopted an unduly light-touch approach to financial regulation. The criticism has been raised after serious failings and abuses in the UK financial sector, and it is based on the idea that financial market participants are often tempted by powerful monetary incentives to act less-than-completely altruistically.

But the issue is complex: not all finance professionals are selfish and greedy. How should regulation be framed in contexts that include multiple actors with different kinds of motivations and values? Ayres and Braithwaite (1992) propose an interesting strategy, called the '*benign big gun' approach*. The idea is to create a regulatory system that combines persuasion – and thus recognition of positive intrinsic motivation – with severe but targeted sanctions on misbehaving persons. This approach builds on the game-theoretic notion of tit-for-tat strategies, which imply that regulators should normally treat regulatees well, but if their trust is broken, they should respond with punishments, the severity of which is measured in accordance with the seriousness of the offense. Importantly, the success of the benign-big-gun strategy hinges on the ability of regulators to play both reasonable and tough, and also on the credibility of their threat to raise the severity of punishments as the offenses get dirtier. The argument is that, in the optimal case, most actors will perceive the rules as fair and reasonable, because the ordinary approach is flexible and persuasive; and in addition, there will be no incentives to break the rules, because the punishments for violations are sufficiently tough and certain to come.

One might suppose that the benign-big-gun proposal is perfectly obvious and that is how most regulators operate. Unfortunately that is not the case. Ayres and Braithwaite (1992: 49) cite the case of the US Occupational Health and Safety Administration (OSHA), which seems to operate with the completely opposite logic: 'They constantly nip at firms with flea-bite fines. In most encounters with OSHA inspectors, petty punitiveness is in the foreground and no big guns are in the background.

The result of flea-biting is that cooperation is destroyed without any of the benefits that can flow from tough enforcement being secured. When scholars point to an agency like OSHA to conclude that punishment and persuasion are incompatible, they have not understood the foregrounding of cooperation and backgrounding of punishment that benign big guns can accomplish.'

Indeed, there are numerous examples regulations that fail to combine persuasion with serious sanctions. In the context of financial markets regulation, the US Securities and Exchange Commission (SEC) is famed for its tendency to churn out complex and expensive-to-comply regulations that signal a mistrust of anyone participating in financial markets; but when it comes to dirty play involving multi-million dollar pay-offs, the SEC's punitive responses appear more symbolic than real.[15] Perhaps the same could be said about Finnish competition law and its enforcement: even after a recent decision that raises punishment standards in anti-competitive agreement cases, the level of fines is arguably too low (given low probabilities of getting caught) to create a real deterrent effect.[16] In light of the present discussion, such approaches to regulation are likely to fail on both counts: they cultivate both opposition and disobedience.

Use creative strategies to promote positive social norms. The interesting question is whether other – less interventionist and less costly – strategies could be adopted to foster the formation of positive social norms. The ideas cited in this paper suggest that are various ways in which this can be done. Considered in isolation, their impact may be limited, but many of them could be combined to create a holistic solution to a specific social problem.

Frey's (1997) strategies for encouraging intrinsic motivation were already mentioned earlier, but they are equally relevant here: developing personal relationships, giving participation opportunities, providing rewards (instead of, or in addition to, punishments), etc. Now if we are assuming that the initial situation is rather more negative than positive, such light-touch approaches alone may not be enough, but they should never be completely ignored as if some people were beyond any possibility of change. As Goethe famously said, 'Treat a man as he is and he will remain as he is. Treat a man as he can and should be, and he will become as he can and should be.'

In the literature on social norms and law, some commentators have advocated the notion of 'norm entrepreneurship' (Sunstein, 1996b). The

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[15] See Partnoy (2003) for a series of case studies.
[16] On the optimal level of fines for antitrust practices, see Wils (2006).

idea, common in sociology, is that some individuals have a special role in transforming established social norms through their words and example. The concept can be taken in a value-free sense: 'norm entrepreneurs' may change social norms for better or for worse.

From the viewpoint of regulation, the idea of norm entrepreneurship is highly important. It may of course be difficult for politicians and regulators to change powerful social norms (Posner, 2000). Ordinarily, the only way to change social norms is to violate them in a public and decisive way, and such behavior can be especially risky for public officials, who are so dependent on their acceptance by the public. However, law and regulation may play a role in supporting actions and role models – for example authors, artists and actors – that are committed to challenging harmful social norms. Such support may include, among others, financial and moral support, and protecting such social actors against persecution in the public square. [17] In economic terms, we could say that such legal and regulatory strategies aim to alter the payoffs of potential norm-entrepreneurs. Such strategies obviously call for a high degree of prudence, because they may backfire, and it is difficult to predict all the unintended consequences flowing from attempts to manipulate social norms.

Use creative strategies to cultivate other-regarding behavior. It may also be possible to encourage altruistic behavior in some regulatory settings. As Frank (1987, 1988) has pointed out, personal face-to-face contact tends to advance mutual understanding and altruism. This can be illustrated by a counterexample that is familiar to most readers: car-driving. Most drivers become impatient and annoyed much more easily behind the wheel than they would in other situations. According psychologists, the explanation is that conflict situations between different drivers are faceless and non-communicative, which obstructs the development of mutual understanding.

This has at least two implications for regulatory strategy. The first is that when cooperation is needed, the enforcement of laws and regulations should be designed in such a manner that there are sufficient opportunities for personal, face-to-face contact. This strategy can also be used when the challenge is to obtain cooperation in the sense of fairness and honesty; it is simply much more difficult (even for physiological reasons) to lie face-to-face than in an impersonal letter. One can think of many potential areas of application, including the enforcement of tax and competition laws. Note however that in order to promote cooperation and fairness, the rules being

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[17] Posner (2000: 30) points out that some famous 'norm entrepreneurs' were fabricated, Martin Luther King, Jr., being perhaps the most famous example.

enforced must also be seen as fair and reasonable; but the positive side is that personal contact and the exchange of ideas will normally help to create a more affirmative attitude toward the rules too.[18]

The second implication is that laws can be employed to frame the relevant institutional set-ups so as to reduce to need for external intervention. For example, when the aim is to reduce egoistic or greedy conduct by certain individuals, the problem may be alleviated by reducing the amount of impersonal dealings and obliging more personal, face-to-face contact between the relevant transactors. Financial markets and company law are just some potential areas of application.

These examples demonstrate the importance of taking altruistic and fairness-based behavior into account in all legislative and regulatory deliberations. However, altruism cannot always be relied on, and it is necessary to understand the influence of the context. For example, when there are powerful financial or other incentives to cheat or to be selfish, high ideals and internal constraints are more likely to be pushed aside (Rabin, 1993).

Encourage good moral habits and protect the 'moral ecology' of the society. Finally, it is possible to encourage good moral habits. Law has an obvious role of play in this regard in the sense of promoting basic fairness and justice: in the absence of criminal, contract and accident law, many more people would be tempted to opt for unjust modes of conduct. In light of virtue ethics, such conduct would reinforce bad habits in those persons, making them morally worse.

However, virtue in the fullest sense cannot be forced from without; it must involve the free decision of the person to do the good. In this sense, law can play a limited role only. Good moral habits are fostered mainly through one's upbringing, education, role models, example of one's peer group etc. The main responsibility lies therefore in the various institutions of the *civil society*: families, schools, churches, associations and so on.

Nevertheless, the state can make important decisions in this respect too. Just like laws and regulations facilitate the activity of certain 'norm entrepreneurs', similarly they influence the institutional setting in which the civil society operates. Educational laws give direction to the curricula of schools and universities; laws on marriage and the family influence the stability and health of natural families; laws on religious freedom, and even tax laws, influence the ability of religious communities to take formative activities upon themselves; and through its budgetary choices, the state

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[18] For further discussion in the context of tax policy, see Cowell (1992) and Vihanto (2003).

makes numerous decisions that sustain certain social and cultural activities instead of others. Note also that, because of crowding-out problems, even basic social policy choices have complex but powerful consequences on the vitality and social role of various kinds of voluntary associations and charitable organizations (see Beito, 1992, and Arffman, 2008).

This perspective of moral habits is not much talked upon today, and it would be easy to dismiss it as secondary, unimportant, or simply too vague. Such skepticism is not warranted. There is a wealth of evidence supporting the view that people are significantly influenced by various educational and social factors, and that good influence can help change them for the better. Perceptions of good life – based on one's upbringing, education, and books and movies – have an empirically measurable effect on moral attitudes.[19] There are also encouraging results from certain programs aimed at helping prisoners avoid a criminal career.[20]

In order to cultivate moral virtues, it is also necessary to protect what some have called the *moral ecology* of the society (George, 1993). This broad concept refers to the totality of moral and cultural factors which helps the upright moral development of persons and groups. The protection strategy here can mean many things, including the regulation of advertising so that the natural desire of companies to do more business will not corrupt individuals (young persons in particular) by promoting images and ideals that display materialistic and hedonistic lifestyles, fail to reflect and respect the dignity and rationality of human persons. Similarly, in such fields as entertainment, there is a danger that sales are boosted by way of resorting to the exploitation of human temptation and moral weakness, and public authorities can legitimately act to restrain such influences, especially because the logic of competition may otherwise create pressures for all market participants to engage in dubious practices. Laws might also deliberately aim to protect the public against harmful norm entrepreneurs, i.e. influential individuals that spread norms and values that are destructive of life in society.

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[19] For example, economics and business education has been criticized for implicitly promoting an egoistic and materialistic ideal of life. Individual cases may differ, but empirical studies confirm that economics, finance and business students display substantially more greed in ultimatum game experiments than do control groups.

[20] One study finds that Prison Fellowship's InnerChange Freedom Initiative participants were 60 percent less likely to be re-incarcerated and 50 percent less likely to be re-arrested than the comparison group (see Johnson, 2003).

Obviously, much prudence is needed.[21] Intrusive intervention in social life risks giving rise to moral paternalism, which may backfire in the longer term. Fundamental values such as freedom of expression are also involved; and taking a moral stand in a pluralistic society provokes the question of conflicting values. Nevertheless, these difficulties alone may not be a sufficient reason to go from one extreme to the other, from paternalism to libertinism. It is generally acknowledged that freedom of expression is not an absolute value, as it needs to be balanced against other human and fundamental rights. Similarly the mere existence of different values is not in and of itself a good reason for taking (whether actively or passively) a particular stand in the debate; and to treat all norms and values as equally laudable is also a position that calls for justification by independent reasons.

Enforcement Strategies

There are numerous reasons why social norms and internal constraints – either alone or supported by legal enforcement – may provide an attractive basis for enforcing socially desirable regulations. They may yield *more effective results*; they may imply *lower costs* for both regulators and regulatees; they may be *more flexible* and also more deeply rooted in *those concerns that matter* (for example, in the case of personal, long-term relationships); and they may *reduce formalistic confrontation*, which tends to corrode cooperative attitudes and positive social norms.

It is not easy to formulate any general principles or guidelines for social-norms-based enforcement strategies, and in any case the enforcement aspect of social norms has been implicit in the foregoing analysis of alignment and culture-building regulatory strategies. Here I would only like to make some additional comments.

One question concerns the conditions that make non-legal enforcement *advisable and effective*. As is clear from the previous sections, this depends on the nature and strength of the relevant social norms and moral values. For example, many aspects of business ethics (such as corporate responsibility programs) are not enforced legally, but there are reputational incentives for implementing effective ethics programs in companies. To some extent, these reputational incentives depend on institutional arrangements and social expectations, which in turn are shaped by various

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[21] See George (1993: 42) for an insightful discussion of the various prudential considerations which might militate in favor of a policy of tolerating certain moral evils.

social-norm entrepreneurs. It can be argued that many aspects of corporate responsibility should not be legally enforced, because the complex and aspirational character of business ethics implies that codifying its requirements in legal enforceable codes would be likely to stultify its development and to discourage ethically-orientated businesspeople; the difficulties involved in measuring and verifying corporate responsibility variables also argues against the over-judicialization of the field.

On the other hand, the effectiveness of informal enforcement depends on many factors such as the financial incentives to violate social and moral norms. It may also be that, although the general public strongly disapproves of certain conduct, the disapproval remains mostly a private matter because it is not transformed into concrete and relevant action. These concerns seem to hold in the context of anti-competitive agreements among businesses: the expected financial gain can be significant, and the reputational penalty seems to be less significant.[22]

The other important question concerns *the role of law and the state* in the design of non-legal enforcement. For example, reputation effects can be deliberately influenced by laws and regulations. A topical example is the decision of the Estonian Ministry of Justice to publicly 'name and shame' parents who have failed to make maintenance payments after divorce. The reason for the decision seems to be that there have been difficulties in enforcing maintenance agreements through the court system.

More generally, law plays a *supportive role* even when the principal method of enforcement is non-legal. Law strengthens social norms through its expressive function and may give them necessary moral support. The specific content of social norms may also depend on laws and regulations; for example, standards of fairness can be shaped by legal rules even when they are enforced non-legally. Finally, benign-big-gun strategies of regulation require that there exists the threat of powerful legal sanctions, which to facilitate cooperation between regulators and regulatees on a more flexible basis.

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[22] On reputational penalties for corporate crime generally, see Alexander (1999).

Conclusion

I have argued that regulatory strategies could be improved in two ways. Firstly by looking beyond laws and regulations to the realm of social norms and other sources of normativity that govern human choosing and acting, and secondly by becoming more conscious of the role of motivations, moral character and culture. I have tried to show that these perspectives can fruitfully be translated into regulatory strategies that (i) align laws with positive social norms and motivations, (ii) seek to foster positive norms and cultivate moral habits, and (iii) rely, when appropriate, on moral and social norms for the enforcement of laws. The goal of this paper has not been to replace pre-existing wisdom, but to propose ideas that may give new insights and show directions for new initiatives. Its application in specific fields of regulation requires further discussion, experience and learning.

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