CHAPTER 7

Social Norms and Law and Economics

Where norms govern individual behavior, one cannot correctly assess the effect of formal, state-enforced rules [read “law,” “rights,” “working rules,” “legal doctrines,” etc.] without understanding the informal rules also at work. . . . [F]ormal and informal rules form a complex web of incentives that influence behavior; a new economics literature has begun to view norms as central to the study of law.

(McAdams 1997, pp. 346, 350)

INTRODUCTION

The analysis of social norms has become an important—many would say the hottest—movement in contemporary Law and Economics (Ellickson 1998, p. 543). While traditional legal theory was built on the notion of reasonable individuals who are “socialized into the norms and conventions of a community” (Cooter and Ulen 1988, p. 11) and behave according to those dictates, most approaches to Law and Economics have relied almost exclusively on the rational choice model of human behavior—an approach that has largely ignored the role of forces such as social norms on individual behavior. The genesis of social norms analysis in the Law and Economics’ literature is often attributed to Robert Ellickson’s path-breaking book, Order without Law, which was published in 1991. In the ensuing years, the scholarship in this area has grown exponentially and reflects several different perspectives on the role and analysis of norms.1 Lawrence E. Mitchell (1999, p. 179) notes that this work began to take hold as legal-economic scholars sought to “understand the role that norms play in ordering society and social groups outside the sphere of norms promulgated by the state, and the ways in which these social norms interact with the norms we call law.” This line of inquiry, he said, offered “enormous potential to enrich our understanding of the ways in which we . . . cooperate with one another to achieve both individual and common goals.”

Specifically, proponents of the social norms’ approaches argue that the inclusion of social norms into Law and Economics’ models makes for robust explanations of behavior and more accurate predictions of the effects of legal change. In the remainder of this chapter we will outline some of the work in this area as well as highlight issues and questions that confront those trying to incorporate social norms into the field of Law and Economics.

We have emphasized throughout this book that much of Law and Economics hinges on the recognition that changed law alters incentives and thereby channels the behavior of individuals in society through the threat of legal sanctions. This legal centralist or consequentialist account of law employs a rational choice or behavioralist approach to describing and evaluating outcomes brought on by legal change. The legal centralist approach was depicted graphically in figure 1-1, which is reproduced in figure 7-1. Here, we can see the path via which a change in law will systematically alter incentives, which alters behavior and, ultimately, economic performance.

From this vantage point, a legal change, for example, the prospect of having to pay higher civil fines or serve longer criminal jail sentences, raises the price of conduct that violates the prevailing laws. This higher price alters the relative magnitude of the benefits and costs associated with those forms of conduct and thus will reduce their frequency. For example, raising the fine for speeding causes fewer people to exceed the speed limit, more severe penalties for cheating on one’s taxes results in greater compliance with tax laws, and higher penalties for polluting reduce the amount of pollution emitted into the environment. For the legal centralists, then, the way to change behavior is to change incentives through changes in law. This approach gains legitimacy to the extent that it can be shown that there is a known and reliable nexus between the said change in law and the consequent outcome.

While the legal-centralist argument still constitutes the core thinking in much of Law and Economics, the social norms’ literature emphasizes that values infused into the habits, customs, mores, and social norms also influence or regulate conduct. That is, certain patterns of behavior may also be induced, not only by changing law, but also by altering habits, customs, mores, and social norms. The argument here is that there is something fundamental about the nature of human interaction that is not adequately explained by the extant models of human behavior found in the various schools of thought in Law and Economics—particularly the rational-choice based approach used by both the
DEFINING TERMS

At this point, we need to define some terminology. By “habit” we mean individualized repetitive behavior that is undertaken without forethought; one behaves a certain way without reflecting on how it might be done differently or the impact if it were done differently. “Custom” includes the surrounding social structure and suggests that individuals in the social group will behave in a similar manner when confronted with the identical circumstances. “Mores” are folk ways so basic as to develop the force of law. Thus, habits, customs, and mores tend to channel human behavior in particular directions. The legal-economic consequences of their role becomes important because when an individual’s behavior is systematically influenced by habits, customs, and mores in ways that, for example, rational choice theory would not predict, those predictions coming out of a legal-centralist approach may overstate or understate the behavioral response to a proposed change in law.

Moving on to social norms, we will use Richard A. Posner’s (1997, p. 365) definition of a norm as “a rule that is neither promulgated by an official source, such as a court or a legislature, nor is enforced by the threat of legal sanctions, yet is regularly complied with.” Robert S. Goldfarb and William B. Griffith (1991, p. 60) described norms as “rules of behavior that constrain the individual’s interactions with others,” noting in particular that they “often operate to constrain the full-blown pursuit of ‘narrow self-interest.’” Social norms are typically not thought to spell out a precise set of behaviors to follow, but instead, like habits, customs, and mores, tend to rule out a range of actions or behaviors.

Contributors to the social norms’ literature come from the disciplines of economics, law, political science, sociology, and philosophy, and each in their own way attempts to explain the origin, function, and impact of social norms. They share the view that the social-norm producing process—broadly conceived as the complex arena of learning and socialization through education, religion, peer behavior, family, and surrounding culture—may also explain why some people do not speed on the highway, do not avoid their tax obligations, and do

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2 These definitions are taken from Koford and Miller (1991b, pp. 22–26).
3 More generally Brennen (1991, p. 85) writes that norms are “behavior-guiding moral principles.” The fact that the definition of a social norm varies so much among contributors has led Basu (1998, p. 476) to conclude that “Like cows, social norms are easier to recognize than to define.”
4 All of these definitions notwithstanding, to avoid the tedious need for duplicative listings, we will follow the lead of many contributors to the literature and, for the most part, from here on conflate all of these terms—“habits,” “customs,” “mores,” and “norms” into the inclusive term “social norms.”
not pollute the environment, even when the cost of doing so is low relative to the perceived benefit, in a traditional economic sense. As Richard H. McAdams (1997, p. 346) puts it, “Where norms govern individual behavior, one cannot correctly assess the effect of formal, state-enforced rules without understanding the informal rules [e.g., social norms] also at work.” Hence, it is not enough to say (as we have described in chapter 1) that legal change affects incentives, behavior, and ultimately economic performance; there is more to it (see figure 7-2).

First, law is, in part, the outcome of a complex process whose evolution is inspired by morally based values and social norms—themselves embedded in a long tradition of political and legal thought. This relation is depicted in figure 7-2 by the vertical arrows going from social norms and morally based values up to the law. Beyond the incentives created by the legal structure, behavior is also a function of both (1) the content of societal norms, customs, and mores that create yet an additional set of incentives and thereby also induce certain patterns of preference formation that impact economic performance, and (2) the morally

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5 Lessig (1998, p. 662) uses the term “regulation” to describe the combined relationships between (1) law and performance on the one hand, and (2) social norms and performance on the other. By this, Lessig means that both social norms and the law “regulate” behavior or conduct, and thus performance.

6 The fact that the law (as well as behavior) is norm based is emphasized throughout this literature. Thus one reads that “[l]egal centralists believe both that the state is the fundamental basis of political organization and that law constitutes a unified hierarchical system of norms” (Yngvesson 1993, p. 1788). See also Cooter (1995).

7 “In sum, formal and informal rules form a complex web of incentives that influence behavior” (McAdams 1997, p. 350).
based values that influence or regulate conduct, either working independently of social norms, working together with social norms, or working in opposition to the prevailing social norms. Furthermore, behavior is also affected by technology, which expands the choice set for production and consumption.8

From the vantage point of figure 7-2, not only are social norms and technology incorporated into the analysis, but so too is the recognition that as economic performance unfolds, as consumer demand shifts, as technologies change, as new resources are discovered and old ones move toward depletion, as new opportunities arise while past successes dwindle, and as competition ensues, the economy changes over time. In a dynamic economy there is a reverse link going from economic performance back to the law; that is, new economic circumstances will invite new calls for additional changes in law or new policy initiatives.

GOVERNMENT, TECHNOLOGY, AND ECONOMIC PERFORMANCE

Before delving into a discussion of the role of social norms and their impact, we will briefly explore the impact of government and technology on economic performance.9 Technology expands the choice set in both production and consumption. As a consequence, new technologies affect individual and group behavior and ultimately economic performance. While technologies may come about through private initiatives, oftentimes the government is involved in driving certain technologies—sometimes directly, other times indirectly—by committing resources to them (see G in figure 7-2). The impact of government driven technologies on the economic sector manifests itself in different ways, four of which are touched on here.

First, the government can simply allocate resources to drive certain technologies to the direct benefit of particular industries. The fields of energy, transportation, agriculture, and medicine and pharmaceuticals and, of course, the military are sectors of the economy where government departments allocate their scarce resources to support selected technological initiatives (and, due to scarcity, not others).

Second, in other instances, the government’s commitment of resources to certain fields (for example, the military) results in technological innovations that spill over into the nonmilitary sector. Nowhere is this more evident than in the case of the Defense Advanced Research Projects Agency (DARPA), the central research and development organization for the U.S. Department of Defense. This is an agency that brings together the academic, industrial, and mili-

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8 Government’s impact on technology will be explored in the next section.
9 This section on government, technology, and economic performance borrows from Mercuro (2004). It is intended to complete the discussion of the combined impact of changing law, social norms, and technology on the economy and should not be thought of as part of the social norms literature.
tary communities in an effort to invest in basic and innovative technologies and to explore revolutionary ideas dedicated to fostering and advancing technologies and systems that create significant advantages for the U.S. military. While its focus is on military technologies, it also develops generic technologies—most notably those related to microelectronics, computing, networking, and other information technologies. The technologies that they have developed and are developing have nonmilitary applications and consequently those in the market sector have and will continue to adapt to bring their many innovations into the marketplace. As for technological developments outside of the military, DARPA's most significant accomplishment was in its work on ARPANET, a telecommunications network that was the precursor to the Internet.

Third, government also impacts economic performance by forcing certain technologies onto society, and, as expected, the market sector responds accordingly. Nowhere is this more evident than in the fields of environmental protection and homeland security. For the past forty years, the U.S. Environmental Protection Agency has largely relied on a command and control approach that has forced certain technologies (BAT—best available technologies) on select industries. The consequence is that individuals in the market sector are acutely attuned to the government-proscribed requirements, and have stepped in and supplied the required air-emissions and water-effluent abatement equipment. Precisely the same phenomenon is currently taking place as the Department of Homeland Security begins to require the government (at all levels) and private industries to adopt certain technologies and systems in its effort to defend the homeland. Again, just as with the case of environmental protection, we see firms in the market sector closely monitoring developments within the Department of Homeland Security and situating themselves in the marketplace ready to provide a market-sector response to government’s technology-forcing directives.

The last example of the government’s impact on technology and economics has to do with the online federal government information and services center run by the U.S. Small Business Administration. This branch of the SBA views itself as the vehicle by which U.S. businesses can connect with federal agencies, providing firms with specific business tools and resources to grow their businesses and create jobs. It has tried to become an established nexus between government and all facets of business development, including information technology, resources for capital and credit, laws and regulations, and international trade information (for export promotion and financing international

10 To get a sense of the many new technology initiatives and programs being undertaken under the auspicious of DARPA, see the lists provided by DARPA's Advanced Technology Office and the Defense Sciences Office at http://www.darpa.mil/body/off_programs.html.

11 There are also several other units of the federal government that are in the technology information-provision business.
trade). It also has specific programs, such as Tech-Net, which describes itself as the electronic gateway of technology information and resources for and about small high-tech businesses. Essentially, Tech-Net is an Internet-based database of information concerning small business innovation research, technology transfer, and advanced technology programs.\textsuperscript{12}

The point here is that many technologies result from the government’s direct and indirect role in advancing certain technologies by committing resources to technological innovation and development and by providing information about new technologies—all of which impacts economic performance across the economy.\textsuperscript{13}

\section*{AN ASIDE ON SOCIAL NORMS AND ECONOMICS IMPERIALISM}

Before delving into a discussion of social norms and law and economics, it is important to take a moment to distinguish between economics imperialism on the one hand, and the social norms literature on the other. In a nutshell, there is a distinction to be made between using economics to address behavior that is morally based, and incorporating social norms into a larger behavior theory to inform economic thinking. Gary Becker, one of the founders of the Chicago school of law and economics and the individual most responsible for advancing economics imperialism,\textsuperscript{14} has pioneered the economic analysis of moral behaviors such as charity, altruism, and honesty. Elements of these moral behaviors are said to provide utility—perhaps more for some people than for others, given people’s differing preference structures—and enter the individual’s utility function just as do other goods. Just as more books to read or more movies to watch enhance the individual’s utility, so too can one’s utility be enhanced by being the provider of charity or by engaging in altruistic or honest behavior. That is, people do not engage in these moral behaviors because it is “the right thing to do” in some philosophical or religious sense, but because (and to the extent that) they are better off in doing them than in not doing them.

The economics imperialism models accept the individual’s preference set as a given and thus do not require a theory of preference formation; one need not ask why an individual’s utility is enhanced by reading another book or watching another movie, or acting altruistically. Robert Cooter (1998, p. 597), a major contributor to the social norms literature, has criticized this type of economic analysis of moral behavior on the grounds that it “trivializes moral commitment by treating it as an exogenous taste.” Those who support the

\textsuperscript{12} See http://tech-net.sba.gov/index2.html.

\textsuperscript{13} Our purpose here is merely to describe what is transpiring; there is no intention to advocate for or against this role of government.

\textsuperscript{14} Gordon Tullock, too, played an extremely prominent role here.
extension of the economic approach to human behavior beyond those activities traditionally considered “economic” do offer a defense against critics who argue the narrowness, inaccuracy, or even the tautological nature of the rational choice model. For example, Charles Plott (1987, pp. 140–41) maintains, “The fact that preferences might include or reflect moral considerations [perhaps activities with a moral component] does not, on the surface, contradict a theory of rational choice or maximizing behavior.” In what they consider the absence of a better or sufficiently operationalized alternative theory, the rational choice theorists remain content with the ex post rationale or explanation as to why we observe individuals engaging in behavior described as charitable or altruistic: it is because it enhances their welfare. As will be seen in the next sections, the social norms literature suggests that the process is somewhat more complex.

**ISSUES IN COMPLIANCE AND ENFORCEMENT**

Law and social norms both work to regulate behavior and, in particular, to induce patterns of behavior consistent with larger social goals. Our discussion of Chicago law and economics suggests that people comply with legal rules because of their unwillingness to bear the costs associated with noncompliance—usually fines or jail time. But what about social norms? What is it that causes people to comply with norms absent the forms of legal punishment that we witness in the legal arena? Two aspects of this question will be addressed. The first is the nature of the subject’s compliance with respect to law as compared to compliance with social norms. The second deals with whether social norms are adhered to because they have been internalized or because of fear of external nonlegal sanctions. That is, with respect to the latter, the literature identifies and delineates norms as informal social regularities that individuals sometimes feel a compulsion to follow because of an internalized sense of duty or obligation, or because of a fear of external nonlegal sanctions, or both (McAdams 1997, p. 340). Each of these will be explored.

Steven Shavell (2002) suggests that behavior can be regulated in three ways: (i) exclusively by law—for example, the entire spectrum of technical, administrative legal–compliance rules; (ii) exclusively by social norms—for example, keeping appointments and engaging in those many activities that come under the rubric of “good manners” and being a “good citizen”; or (iii) by both law and social norms—as illustrated by the common belief that most crimes and torts are thought to be both legally sanctionable and outside of

15 As Koford and Miller (1991b, pp. 24) observed, “There is a large overlap between internalized norms and customs. Once learned, these norms become part of customary practice and individuals rarely reflect on them when they act.” See also Etzioni (2000).
socially accepted norms. Both social norms and the law rely on mechanisms beyond the self for enforcement and inducing the subjects’ compliance, but these mechanisms differ in form and implications. In the case of law, subjects comply under the will or sanction of the sovereign; in the case of norms, subjects comply under the will or sanction of the community. This distinction deserves some elaboration.

Law and legal change are expected to change individual behavior. We expect people to comply with laws because the sovereign has told us to do so and will punish us if we do not. Here we see a negative component to violating the law: we comply to avoid the negative impact of having to pay the raised fine for speeding, the more severe penalties for cheating on our taxes, or the higher penalties for polluting. On the other hand, individuals comply with social norms because the community has told them to do so. In this case, we have both negative and positive components. On the negative side, the community will punish us if we do not comply, by inflicting some form of disapproval and admonition, whether via psychic cost in suffering guilt through a sense of “letting down the community” or perhaps even physical ostracism such as being cut off from some or all of the benefits of participation in the community. On the positive side, if we do comply, the community rewards us for conforming to the social norms by expressing itself in ways that allow us to experience feelings of virtue, feel that we have lived up to our duty or obligation, enjoy the praise of the community, and experience an enhanced sense of esteem, or perhaps by allowing us to secure the larger resource benefits associated with community membership.

Both internally enforced social norms and externally enforced social norms provide signals as to what we should or should not do under a given set of circumstances and are therefore obligatory upon those individuals who wish to participate in the society that is at least partly constituted by such social norms. What the literature on internally enforced social norms emphasizes is the fact that the socialization process—through education, religion,

16 Shavell (2002, p. 229 at n. 2) observed that a “sustained analysis of the optimal domains of law and of morality from an instrumental, economic perspective does not seem to have been undertaken.”

17 It should be noted here that the law and economics social norms literature has not reached any consensus as to how to treat organizational rules—what have been termed “working rules” in this book. There are no definitive categories lying between centralized formal law on the one hand and decentralized social norms on the other. Organizational rules fall between the two, raising the question, “Should we treat them as law or norms?” McAdams (1997, p. 351) described this quandary: “The distinction is important because some theorists prefer to use the term ‘norms’ to refer only to decentralized rules and regard organizational rules as a set of obligations falling between centralized law and decentralized norms.” McAdams (1997, at fn 59) went on to observe that this was Ellickson’s approach where he described “three sources of third-party control: governments provide legal rules, organizations provide organizational rules, and ‘social forces’ provide norm-based rules. . . . [Thus,] in this taxonomy, organizational rules therefore are not ‘norms.’”
peer behavior, family, and surrounding culture—brings about the internalization of social norms. Individuals internalize the normative component of the adopted norms and thereby set up a parallel structure of incentives that induces them to behave in accordance with these norms (see figure 7–2). The self-enforcement comes about through self-administered feelings of guilt and disapproval, pride and status, and so on. Individuals behave in a manner consistent with the incentives fashioned through their socialization and, in doing so, with the internally enforced social norms.

This concern with internally enforced social norms marks a departure from neoclassical economics, which treats individual tastes and preferences as exogenous. As Ellickson (1998, p. 540) points out, the legal-economic models—particularly those advanced in the Chicago school—constructed on a neoclassical framework feature “unsocialized individuals in their analysis of hypothetical legal problems.” Ellickson goes on to argue that by suppressing the role of socialization, the Chicago approach to law and economics intentionally or unintentionally exaggerates the focus, and thus the importance, of legal centralism. As against the models of neoclassical economics, the social norms approach posits that aspects of individual and group behavior can be explained as people behaving in a manner that complies with those societal norms that are “internalized” and thereby impact preference formation, affect behavior, and ultimately, impact economic performance. The point, then, is that some social norms impact economic performance simply because they are internally enforced by agents and without reference to any sort of external sanction.

Externally enforced social norms also have a direct bearing on an individual’s behavior and thus on economic performance. From this external vantage point, social norms are part of the background milieu against which individuals make choices. Once these norms are in place and incentives are established, the machinations of private and public choice unfold. To the extent that these norms differ across communities, the outcomes of the choice process, too, will differ. Unlike internally enforced norms, those that are externally enforced rely on the efforts of the norm-generating community. External enforcement of social norms is more likely to the extent that (i) there is homo-

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18 This is sometimes referred to as the “rationality-limiting norm,” whereby “certain alternatives may be infeasible to an individual not just because they are technologically infeasible or budgetarily infeasible [both consistent with neoclassical economic analysis] but because they are ruled out by the person’s norms” (Basu 1998, p. 477). Basu goes on to define two other types of norms: some are “preference-changing norms” (e.g., the religious norm not to eat meat manifests itself into a preference for vegetarian foods) and others simply help society select an equilibrium—so-called “equilibrium-selection norms” (e.g., the decision to drive either on the right side or the left side of the street).

19 The Institutionalists and New Institutional Economists would call this part of the institutional framework within which choices are made—a framework that conditions, informs, and in various ways both facilitates and constrains choice.
geneity of the social group, and hence a common core of external expectations; (ii) members of the group are well informed and similarly endowed; and (iii) the interacting parties have a continuing relationship be it in the form of friends, acquaintances, bystanders, neighbors, or trading partners. Compliance with these norms occurs for both positive reasons—for example, to attain greater esteem or be granted a position of higher social status—and for negative ones—for example, to avoid ostracism or negative gossip. Thus, in acknowledging the presence of certain societal norms, some facets of individual and group behavior can be explained in terms of people behaving in a manner that complies with the externally enforced social norms, and this behavior, in turn, can impact economic performance.

It would seem, then, that social norms matter in legal-economic analysis for a number of reasons. McAdams (1997, pp. 347–50) offers an instructive matrix of three possible impacts on performance. First, social norms can matter because they sometimes control individual behavior to the exclusion of law. This is the case, for example, with laws governing the Prohibition movement of the 1920s and 1930s and the property norms followed by ranchers in Shasta County irrespective of the formal law. Second, norms and law may work independently to influence behavior in the same direction. We see this in cases such as those where the laws to obligate tax paying are reenforced by the social norm to pay taxes, and the anti-theft laws are reenforced by the social norm not to steal. Finally, law may intentionally or unintentionally influence social norms themselves. For example, legal restrictions on public smoking may have strengthened an anti-smoking norm; the passage of the Civil Rights Act of 1964 may have affected the prevailing social norms sanctioning racial discrimination; and the passage of Title IX in 1972 may have influenced the prevailing social norms related to women’s participation in high school and college sports. This matrix of possible impacts on performance is important because it brings to the fore the point that the effects of legal change will depend on the nature of the proposed legal change and the community of social norms to be engaged. Therefore the effects of a proposed change in law will likely vary, depending on whether the legal change is running with, running against, or altering prevailing social norms.

20 Richard Posner (1998b, p. 554) describes some of this behavior or this class of interaction as “signaling theory” whereby “people engage in behavior that they may not value in order to signal their loyalty to the group with which they may have their most valuable interactions or, more broadly, in order to establish a network.”

21 The latter example is more fully explored in the section titled: “Social Norms at Work.”

22 As is elaborated on later, the fact that law can influence social norms/behavior and ultimately performance, is of great interest to the law and economics school of norms in that it provides a rationale for state activism for the New Chicago school.
bent in particular, if not in tune with the interaction of norms and legal rules in the area impacted by a proposed legal change, may drastically mis-estimate the effects of alterations in law and thus be less than successful in accomplishing their aims. Thus, in retrospect, given the force of these various arguments, Ellickson may have been right in criticizing Law and Economics in the early 1990s for having largely ignored the inclusion of social norms—norms that are now recognized as the central informal means of social control impacting economic performance (Ellickson 1991, pp.137–55).

SOCIAL NORMS AND THE EVOLUTION OF THE “NEW” CHICAGO SCHOOL

Lawrence Lessig (1998) provides us with a simplified and useful delineation of the evolving treatment of social norms within the “Chicago” approach to law and economics (broadly conceived), culminating in what he calls the New Chicago school. The “old” Chicago school, in its several manifestations, argued against the widespread use of the law and argued for the dominance of other systems of social control—with the market being their preferred alternative. In its attempt to elevate the market, old Chicago arguments often functioned to diminish the significance of law. As Lessig (1998, p. 665) describes this view, “[L]aw is, relative to these other constraints, a less effective constraint: Its regulations, crude; its response, slow; its interventions, clumsy; and its effect often self-defeating. Other regulators, the old school argues, regulate better than law. Hence law, the argument goes, would better let these [other] regulators regulate.” That is, the old Chicago perspective asserts that “Law should understand its own insignificance . . . and should step out of the way,” allowing for more incentive-based market approaches, rather than the command and control-type regulations that typically carry the day.

The first-generation of law and economics theorists to incorporate social norms into their analysis and scrutinize their influence, like old Chicago, considered law and social norms to be relatively autonomous phenomena. Some of those contributing to this first generation of social norms literature came from the Law & Society movement, while other contributors, like Janet Landa, Cooter, and Ellickson, came from those more closely tied to the Chicago approach to law and economics.23 The lesson they transmitted to their generation of legal-economic scholars was that, like law, norms do indeed regulate behavior. Within this first generation of literature, however, social norms were considered independent of the law and appeared fixed, essentially unmoving, and unyielding to the influences of law. As a consequence, since it is the forces

outside law—namely the complex process of socialization—that have a significant impact on behavior, and may, in fact, regulate behavior better than law, these early social norm theorists—not unlike their old Chicago counterparts—concluded that the state would and should be much less active.

It was against this anti-activist backdrop of the old Chicago school and the first generation norm theorists that the New Chicago asserted itself.\footnote{Lessig described his use of the moniker ‘new’ as follows: “The sense of ‘new’ that I mean here is ‘new’ for a Chicago school. The idea is to mark, within each of these separate departments, second-generation work for projects begun long ago. The label is less about discovery and more about organizing work that otherwise proceeds separately” (1998, p. 672). See Ellickson (1998, p. 548), who also provides a brief characterization of New Chicago.} The “new” Chicago school includes scholars such as Cass Sunstein, Dan Kahan, Lawrence Lessig, Kenneth Dau-Schmidt, and Richard Pildes, and the focus of their approach is on the interdependence between law, social norms, and other “regulators” of behavior. For New Chicago, social norms are malleable and the law is there to help change or reform them. In this view, “[L]aw not only regulates behavior directly [à la legal centralists], but law also regulates behavior indirectly by regulating these other modalities of regulation directly”—of particular importance here, social norms (Lessig 1998, p. 666). Sunstein (1996b) contends that since law can strengthen the norms it embodies and weaken those it conflicts with or condemns, the government is in the unique position of being able to advance desirable norms and undermine unwanted ones. This law-norm nexus is also clearly expressed by McAdams (1997, p. 354), who observed that “arguably, the most important relationship between law and norms is the ability of law to shape norms” (emphasis added). He goes on to say that “[i]f legal rules sometimes change or create norms, one can not adequately compare an existing legal rule with its alternatives without considering how a change in the legal rule may affect the relevant norms” (p. 349). For New Chicago, the significance of this can not be overstated: the fact that law can and does affect social norms (as implied by the arrow, G \rightarrow, going from law to social norms in figure 7–3), far from diminishing the role of the government, offers an expanded opportunity for state activity or regulation—here, to alter social norms and ultimately economic performance, in ways that will enhance social welfare.

It is here that one finds the roots of the New Chicago school’s skepticism regarding the anti-activist posture of both the old Chicago approach to law and economics and the first-generation norm theorists. Proponents of the New Chicago approach recognize that “just because law cannot directly or simply control norms, it does not follow that there is not an influence in both ways (norms influencing law and law influencing norms) or that one cannot be used to change the other” (Lessig 1998, p. 673). New Chicago is focused on enhancing our understanding of the mechanisms through which this recip-
rocal influence is effected, on the issues raised by these interactions, and, more importantly, on fashioning social norms as part of solutions to questions of public policy. In doing so, it “identifies alternatives as additional tools for a more effective activism. The moral of the old school is that the state should do less. The hope of the new is that the state can do more” (Lessig 1998, pp. 673, 661). In the same vein, Sunstein (1996b, pp. 907–8) refers to the use of law to influence norms as “norm management,” a practice that he defends as “an important strategy for accomplishing the objectives of law, whatever those objectives may be.” Given that “behavior is pervasively a function of norms” and that “norms account for many apparent oddities or anomalies in human behavior,” the best way to improve social welfare may be via changes in norms. Government, he says, “deserves to have, and in any case inevitably does have, a large role in norm management.”

Needless to say, this interest in and rationale for a more expansive role for government is not a development welcomed by many proponents of the Chicago approach to law and economics. Richard A. Posner, for one, has registered his objection. Posner does not believe that the government should be in the business of manipulating norms and preferences. He argues that “government has a role in encouraging people to be law-abiding,” and that “one wants the government to be as neutral among contending social groups as possible.” Things are different though, he says, “when it gets down to trying to get people to like each other, to change people’s values and make them more tolerant—this whole notion of shaping people’s preferences through government.” Not

FIGURE 7-3. “New Chicago” and Social Norms and Economic Performance
only does he not approve of this, he contends, to “the extent that it is effective, it’s likely to be totalitarian.”

This dispute persists.

To this point, we have seen that the first-generation norm theorists have attempted to incorporate social norms formally into their legal-economic analysis (as depicted in figure 7–2), and that New Chicago not only includes social norms in its legal-economic analysis, but also takes the additional step of advocating the use government to change norms in an attempt to improve human well-being (as implied by the arrow, G \( \rightarrow \), going from law to social norms in figure 7–3). The final aspect of the social norms literature that we want to explore here concerns the question of whether, and, if so, how Law and Economics scholarship should deal with the processes by which social norms evolve and change. That is, a pertinent question for analysis is where the Law and Economics research agenda should enter the nexus between norms, incentives, behavior, and performance.

This very question has been advanced by “sympathetic critics” of the “new norms jurisprudes”—the latter a moniker used to identify those who advance theories of social norms within the context of a behavioral approach that maintains a rational choice perspective, thus includes the old Chicago school, the first-generation norm theorists, and New Chicago.

That old Chicago and New Chicago adopt a rational choice perspective is not in dispute. As McAdams (1997, p. 339) points out, “In recent years, economists and rational choice theorists in philosophy and political science have started to use individual behavior to explain the origin and function of norms.” As Lessig, himself a proponent of the New Chicago approach, notes, the New Chicago School has not completely jettisoned the underpinnings of Chicago law and economics; rather, the New Chicago “shares with the old an interest in alternative modalities of regulation . . . and adopts as well a rational choice perspective (Lessig 1998, p. 666; see also p. 665).

In his thoughtful critique of this movement, Mitchell (1999, p. 21) describes the work of the new norms jurisprudens as taking “an unrelenting behavioral approach to norms,” one that “winds up narrowing instead of broadening their understanding, distorting instead of improving this explanation of norms.” He goes on to say, that the new norms jurisprudens generally share the same basic goal, which is to establish a non-normative theory of norms. The methodological attitude is behavioural; the approach is entirely positivistic. They tend to share an underlying metanorm of efficient wealth or

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25 These quotes are taken from Rosen (1997, p. 176).

26 The leading critic is Mitchell, and this section is drawn from his “friendly critique” of the “new norm jurisprudens” (1999). That it relies exclusively on rational choice is also consistent with Lessig’s (1998, p. 665) observation of the old and New Chicago schools: “Chicago schools, as I mean the term, emphasize this multiplicity of constraint and understand it from the perspective of rational choice.”
welfare maximization, and all share the basic belief that people are motivated principally—if not solely—by self-interest. Most important, 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. (1999, pp. 208–9)27

The critique goes on to suggest that, by being bound to this behavioralist approach—which Mitchell has labeled a “black box” approach—new norms jurisprudences need only to study the impact of changing social norms on behavior. They need not get into underlying values and the evolving, nuanced obligations, duties, or compulsions that come about and bring about the evolution of social norms. This behavioralist approach seems content to start with extant social norms and then proceed to investigate the impact of changing social norms on incentives and behavior, and ultimately on performance. As Ellickson (1998, p. 550) has observed, “Although methodological individualism invites a theory of how actors manage to reform norms, many of us have ducked that challenge, in effect relegating norm change to a black box,” as illustrated in figure 7-4.28

This group of critics contends that one cannot come to a true understanding of the role and impact of social norms via the rational choice accounts of behavior offered by the new norm jurisprudences. They base this contention on the their belief that accounts that focus merely on how people behave, and not why they act as they do, are insufficient. They contend that the new norms jurisprudences maintain a behavioralist posture consistent with their backgrounds in rational choice theory and law and economics, together with a myopic focus on norm efficiency and norm stability.29 That analysis, they argue, focuses on descriptions of “behavioral characteristics that lead to and sustain norm creation,” where social norms are depicted as “nothing more than preferences,” with little attention paid to the processes of preference formation or to

27 Elster (1991, p. 15) maintains a similar critique stating his belief that “social norms provide an important kind of motivation for action that is irreducible to rationality or indeed to any other form of optimizing mechanism.”

28 As Brennen (1991, p. 87) described this aversion, “[N]eoclassical economists have never aspired to predict, explain, or evaluate preferences themselves; their goal has been the prediction of behavior and the evaluation of policy and institutions based on those preferences.”

29 This characterization is fully developed in Mitchell (1999, pp. 189–93).
the evaluation of the desirability of various alternative preference structures (Mitchell 1999, p. 190). As a result, Mitchell (1999, p.180) argues, “[The] relentlessly, behaviouralist accounts of norms provided by the new norms jurisprudences can barely begin to explain the emotionally, psychologically, intuitively, morally, and socially complex questions” underlying why individuals or groups adopt or conform to particular social norms.

These same critics argue that if legal-economic scholars focus on extant norms or state action dedicated to trying to change norms (in hopes of changing preference formation), without any real concern for how those social norms are formed and whether they are desirable, they have not gone far enough. To understand anything meaningful about behavior, and ultimately performance, we need to explore how norms initially arise; that is, we need to understand the nature and source of the obligation that leads one to feel the need, the duty, or the compulsion to comply with social norms. As McAdams (1997, pp. 349, 354) has observed, while Law and Economics scholars may be deeply interested in how law can influence norms: “If we do not know how norms first arise, it would seem implausible to think we could predict how legal rules might change a particular norm.” Proponents of this latter line of thinking argue that we need to understand both what goes into forming the social norms, habits, customs and mores, and the sense of obligation to comply with these social norms. That is, one needs to open the “black box” and focus attention on how underlying values lead to social norms creation and, from there, proceed to try to understand how the likes of the New Chicago norm managers would alter existing norms to better society.

These sympathetic critics are motivated by a belief that we need a richer understanding of norms—perhaps supplied by political scientists, philosophers, and others—at the heart of which should be a robust explanation of the formation, content, and stability of social norms. It is not enough, they argue, to assert that an obligation must be internalized to constitute a social norm and hence impact behavior. We must, they say, go beyond the standard response of new norms jurisprudence, that people conform to norms for merely instrumental reasons such as maximizing wealth or welfare, avoiding punishment, and seeking reward (Mitchell 1999, p. 191). The focus, instead, must be on understanding the process by which norms come into being and become internalized by members of society. A useful or complete law and economics of social norms model must answer the question, “What is it that leads us to feel the need to comply with social norms?” McAdams (1997, p. 352) makes this point directly:

Despite the fact that norms govern behavior throughout society, the origin of norms is, for economists, something of a puzzle. Typically, the new literature

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30 For a concise review of some of the Law and Economics’ explanations as to the origin and impact of social norms, see Eric Posner (1996, 1998a).
simply sets the issue aside. The decision to concentrate on the operation of extant norms is certainly defensible: we gain much by empirical studies of particular norms. Nonetheless, I believe it is fruitful for legal theory to focus on the more elemental question: How do norms initially arise?

MODELS OF SOCIAL NORMS

Before moving on to the next section, where we take a look directly at the law and economics of social norms “at work,” we note that much of this literature is still in the relatively early stages of development. Consequently, there are presently several different approaches and models that explore how one can incorporate social norms into legal-economic analysis. Here we present brief descriptions of five of them—by Robert Cooter, Lawrence Lessig, Richard H. McAdams, Cass Sunstein, and Eric Posner.

From Cooter’s perspective, many economists engaged in the economic analysis of law practice a form of moral skepticism by exploring efficient institutional arrangements for rationally self-interested actors, largely to the exclusion of the role of social norms. He acknowledges the success of the various models built on this moral skepticism, but, not unlike the other models described in this section, Cooter points out that they often fail to explain significant activities of people (2000a, pp. 1578–79).

Cooter’s model takes direct aim at the Becker approach, described earlier—an approach that models behavior by postulating “tastes” for anything (fairness, honesty, etc.) including morality. Indeed, he points out that economists “such as Gary Becker and George Stigler praised this reluctance [to explain tastes] as a methodological virtue linked to scientific rigor” (2000a, p.1592). Cooter also argues that postulating a taste for morality [à al Stigler and Becker] raises the additional question, “What is the difference between an unselfish desire to treat others fairly and a selfish desire to satisfy a taste for treating others fairly?” (2000a, p. 1579). Cooter ends up advocating for (1) an economic theory that explores endogenous preferences, (2) an accepted method to investigate the internalization of values, and (3) a sustained inquiry into the question, “Where do tastes come from?” Cooter’s overall aim is to get legal-economists to “describe the values internalized by people, predict the effects of internalized values on society, and explain why some people internalize values that others do not internalize” (2000a, p. 1579). In short, his is an

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31 In our effort to provide the reader with a very brief review of five different and highly nuanced models that attempt to incorporate social norms into legal-economic analysis, we distilled several rather lengthy articles down to three or four paragraphs each and, in doing so, have borrowed directly from those works, using their language so as to maintain and transmit their unique perspective on the role of social norms in Law and Economics.

approach to Law and Economics that asks legal-economists to chart the distribution, effects, and causes of internalized values.

His definitions of law and social norms are consistent with many of the other models. On the one hand he recognizes the “imperative theory of law,” where law is seen as an obligation backed by a state sanction. On the other hand, a social norm can then be defined as an obligation backed by a nonlegal sanction, the latter of which may take the form of criticizing, blaming, refusing to deal with or shunning (insofar as the people who impose them are not state officials) (2000a, pp.1579–80). Cooter points out that one of the distinguishing characteristics between law and social norms is that legal systems, corporations, churches, and private organizations typically have rules (often within their by-laws) for making, amending, or extinguishing rules. More often than not, however, social norms lack rules for making rules; that is, no definite process exists to create, amend, or extinguish a rule of etiquette or a principle of morality.

In his descriptive model, a model that focuses on social norms that regulate civic acts, Cooter attempts to describe the interaction between actual norms and laws, and to lay out the distribution and effects of internalized values. He analogizes his model to the economic model of consumer theory. In consumer theory, the amount that a person is willing to pay for a good measures the strength of his preference for it. In a like manner, Cooter wants to measure the extent to which a person internalizes a social norm by the amount that he will pay to conform to it. In his analogy between norms and markets, final demand for a commodity corresponds to the intrinsic value (defined as “tastes” or “preferences”) of obeying a social norm. Thus, a person who intrinsically values obeying a social norm will pay something to obey the norm for its own sake, independent of any resulting advantage or disadvantage. In addition, civic acts can also have instrumental value. The instrumental value of civic acts often depends on the advantage gained from having the reputation of being a good citizen. The cost of obeying a social norm is straightforward. Obedience often imposes direct costs in money, inconvenience, effort, risk, or lost opportunity. For example, complying with tax law costs money, cleaning up after a dog is unpleasant, and abstaining from smoking may require effort. A person who has internalized a norm is willing to sacrifice something to obey it (2000b, p. 6). He demonstrates how the interaction between willingness-to-pay and the actual cost of conforming to a social norm determines the equilibrium aggregate level of civic acts.

Normatively, Cooter argues that people change their preferences and internalize morality to improve their opportunities for cooperating with others. Within his model he distinguishes three effects of social norms on law, namely expression, deterrence, and internalization. The state can influence choice by

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33 This is consistent with what has been termed here the “legal-centralist approach.”

34 Expression, deterrence, and internalization are fully developed in Cooter (2000b, pp. 10–20).
credible pronouncements of the law—utilizing its expressive power. When law aligns with social norms, the law can use state sanctions to supplement social sanctions to promote deterrence. Finally, to induce people to internalize values, the state must reward citizens for having civic virtue. For this purpose, state officials must bestow honors, awards, and praise, as well as their opposites (dishonor, punishments, and condemnations).

Since officials have remote relationships with citizens in modern states, the state has little power to induce people to make moral commitments. The primary influences on character are intimate relationships such as families, friends, and colleagues. Given these facts, the state itself will have limited success instilling civic virtue in citizens. Instead, the state should prompt family, friends, and colleagues to instill civic virtue in each other. When some citizens internalize respect for law, pronouncement of a new law can have an expressive effect that causes behavior to jump to a new equilibrium. Given appropriate internalization, legal expression can change behavior dramatically with little state expenditure on coercion. When norms fail on their own, the best system of social control often supplements them with law, that is, the state must align law with social norms. Social norms influence the response of citizens to law through expression, deterrence, and internalization and a better understanding of these effects, including the empirical estimation of their strength in practical situations, can improve social control in the modern state.

Lawrence Lessig’s model aims at synthesizing economic and norm accounts of the regulation of behavior so as to better understand those structures of regulation that are outside law’s direct effect. Changing laws, altering social norms, implementing different architecture, and raising/lowering prices, each in their own way, changes the constraint on a regulated entity, and changing each constraint changes the behavior of that entity being regulated. Specifically, behavior is regulated by four types of constraint, with law being just one of them. Lessig’s conceptual model includes social norms as one of four “regulators”—the others being law, the market, and the prevailing architecture. Specifically, he defines them as follows:

- Law . . . directs behavior in certain ways; it threatens sanctions ex post if those orders are not obeyed.
- Social norms regulate as well, however, they constrain an individual’s behavior, but not through the centralized enforcement of a state. More typically, they constrain because of the enforcement of a community.
- Markets regulate through the device of price. The market constraint functions differently from law and norms, (even though the market rests on property and contract law). Given law, a set of social norms, and scarcity, the market presents a distinct set of constraints on individual and collective behavior.

35 These four regulators are more fully described in Lessig (1998).
• Finally, there is the constraint of “architecture”—something akin to “nature”
constituted of the surrounding spatial and temporal features in the world around
us—whether made, or found. This architecture both restricts and enables in a
way that directs or affects behavior. It is in this sense that architecture also reg-
ulates behavior.

“These four constraints, or modalities of regulation, operate together,” says
Lessig, “and, taken as a group, constitute a sum of forces that guide an individu-
al to behave, or act, in a given way.”

For our purposes, it is the role of social norms within the model that is of
particular interest. For Lessig (1996, p. 2182) “[i]t is not enough to talk about
social norms. We must also speak of social meaning.” Here he tries to go be-
yond what he sees as the typical or usual social-norm “talk” and asserts that
the price (or cost) of certain types of behavior “is a function of the action and
the contextual understandings behind it. Norm talk focuses on the action and
ignores the context” (Lessig 1996, p. 2183); hence he argues for “meaning
talk.”

One must be careful to recognize that Lessig is not concerned here with se-
manitics; his focus is instead on pragmatics. The aim of meaning talk is to find
a way “to speak of the frameworks of understanding within which individuals
live; a way to describe what they take or understand various actions, or inac-
tions, or statuses to be; and a way to understand how the understandings
change” (1995, p. 952). Beyond this, Lessig is also concerned with how these
social meanings can be used by social agents to advance individual or collect-
ive ends. In this, he also makes clear that the government has a role to play in
that “governments, as well as others, act to construct the social structures, or
social norms, or what I will call here, the social meanings that surround us”

Lessig argues for “meaning talk” that has both a descriptive dimension and,
more importantly, a prescriptive component. As to the descriptive element,
Lessig believes that meaning talk can “reveal something more about the con-
tours to the costs of the different behaviors; it imports a language that can un-
derstand discontinuities in the valuation of similar behavior” (1996, p. 2185).
It is the prescriptive facet of meaning talk, however, that has policy implica-
tions. As Lessig noted,

Social structures are differentially plastic, and norms are part of social structures.
But whether a norm is difficult to change depends upon more than mere iner-
tia. . . . [I]t depends as well upon the cost or the price of continuing to engage that
norm. To speak of these prices, however, requires meaning talk, and meaning talk
might in turn cue us to better ways to regulate social norms. (1996, p. 2186)

Thus, for Lessig, constructing social meanings is a collective activity, and as
with any collective activity, as with any public good, inducing individuals to
act to support or reconstruct a particular social meaning involves changing incentives, to induce them to change their behavior (1995, p. 1044). To this end, Lessig emphasizes the interpretive dimension of social norms and underscores the need for the state to consider the social meaning of the behavior it seeks to regulate. He asserts that it is the social meaning of the norm that gives rise to its animating force; that is, what an act signals depends on the norms that define the act’s social meaning. Once the interpretive dimension of the associated norm is known, one can fashion more workable legal policy—remedies and better predict the effect of legal change.

Richard McAdams has become a major advocate for incorporating social norms into economic analysis of law. His primary motivation in developing his model was to understand better and describe the connections between law and social norms and to overcome what he perceived as the many ambiguities that pervaded the social norms literature. He felt that much of what was there was unnecessarily ad hoc in nature and, to this end, offered his own theory of the origin and growth of social norms.

The predicates to the model (McAdams 1997, pp. 350–51) are three. First, norms are enforced by some means other than legal sanctions. Second, McAdams follows the line of literature that views norms as obligations. Third, while nonlegal obligations may be created and enforced in a centralized or decentralized manner, his model explicitly focuses on informal, decentralized obligations. Believing that social norms are a vitally useful tool for explaining behavior and predicting the effect of legal rules, his theory asserts that “the initial force behind the creation of social norms was the desire individuals have for respect or prestige, that is, for the relative esteem of others” (1997, p. 342; emphasis in original). Further, since individuals care about how they are evaluated in comparison to others, the preference for esteem is inherently relative. Thus, social norms arise because people seek the esteem of others—an individual’s utility depends in part on the opinion which that individual perceives others to have of him/her.

The model also identifies several stages in the process of norm development, focusing on the dynamic forces that can cause weak desires for esteem to be transformed into powerful and controlling social norms.

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36 Lessig (1995, pp. 1008–15) goes on to identify four methods of self-conscious transformations or preservations of social meaning and suggests how each method acts as a potential solution to a collective action problem. There are two techniques of semiotics: (i) tying and (ii) ambiguation; and two techniques of behavior: (iii) inhibition and (iv) ritual. He argues that these are four common and sometimes successful methods for a government or for other social meaning architects to alter the balance of semiotic costs confronting someone engaging in, or not engaging in, a particular behavior.

37 McAdams (1997, p. 356 at nn. 78, 79, 80) draws on such evidence as people paying for status goods to signal their wealth or “good taste”; that people incur material costs to cooperate in situations where their only reward is the respect and admiration of their peers; and that individuals conform their behavior or judgment to the unanimous view of those around them to avoid the disesteem accorded “deviants.”
McAdams (1997, p. 358) lays out the conditions under which the desire for esteem produces a social norm. For some particular behavior X in a population of individuals, a norm may arise if (i) denying esteem is a costless means of punishing norm violators;\(^{38}\) (ii) there is a consensus about the positive or negative esteem worthiness of engaging in X (that is, either most individuals in the relevant population grant, or most withhold, esteem from those who engage in X); (iii) there is some risk that others will detect whether one engages in X; and (iv) the existence of this consensus and risk of detection is well known within the relevant population. When these conditions exist, the desire for esteem necessarily creates either “costs of” or “benefits from” engaging in behavior X. That is, if the consensus in the community is that X deserves esteem, a norm will arise as long as the esteem benefits exceed, for most people, the costs of engaging in behavior X. Conversely, if the consensus in the community condemns behavior X, a norm will arise if, for most people, the esteem costs exceed the benefits of engaging in X. In addition, over time, competition for relative esteem may strengthen the norm, produce secondary enforcement norms—sometimes backed by material sanctions—and even cause the norm to be internalized. McAdams (1997, p. 364) describes the process as follows:

If individuals desire esteem, and if these three conditions exist, it necessarily follows that one who violates a consensus incurs a cost. If the consensus is that behavior X is commendable and the absence of X is deplorable, and the consensus is well known, then A will deduce that others will think less of her if they detect her failure to do X. The esteem cost is the probability that a violation of the consensus will be detected multiplied by the value of the esteem that would then be lost. A norm arises when, for most individuals in the population, this esteem cost exceeds the cost of following the consensus. Thus, if most group members prefer bearing the cost of doing X to the esteem cost of failing to do X, most members will do X. Under these circumstances, we can say there is an esteem-based norm obligating individuals to do X.

In summary, McAdams believes that the esteem model provides an analytical clarity that resolves some of the troubling ambiguities in the literature over the meaning of social norms, provides a theory of social norm development, and offers a way to unite what may appear to be unrelated strands of the literature concerning internalized and non-internalized norms, broadly and narrowly defined norms, and group and societal norms.

Cass Sunstein’s model is motivated in part by his belief that libertarians, some economic analysts of law, and many liberals give inadequate attention to the pervasive functions of social norms, social meanings, and social roles in society (1996a, p. 910). Like many of the other models, his has both a positive

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\(^{38}\) If it is not costless to enforce, then the free rider problem arises since if others enforce the norm, the individual can gain the norm’s benefits without bearing enforcement costs.
and normative component. Descriptively, Sunstein seeks to understand the role that social norms play in determining choices, with a focus on their social or expressive meaning. He argues that behavior is pervasively a function of social norms and that norms account for many apparent oddities or anomalies in human behavior. Normatively, he defends the place of law in “norm management,” arguing that an understanding of social norms will help illuminate effective regulatory policy and help guide legal change.

His is a rational choice model where norms are but part of the background against which benefits and costs are assessed. He takes issue with those who attempt to drive a wedge between so-called rational behavior and social-norm-induced behavior, asserting that those who allege a difference rely on obscure “state of nature” thinking that leads to wasted efforts to discern what people would like or prefer in some false world where social norms did not exist. This type of thinking, he believes, is doomed to failure; he argues instead that what is rational for an agent is a function of, and mediated by, social roles and associated social norms (1996a, pp. 909–10). In simple economic terms, people’s choices are a function of social norms, which operate as “taxes” or “subsidies,” and thus the costs and benefits of action, from the standpoint of individual agents, include the consequences of acting (in)consistently with social norms.

Sunstein also takes issue with the idea of “preferences”—and with the term itself—as typically used by economists to reveal choice, asserting that it is highly ambiguous and should be dispensed with altogether. What lies behind choices, as he sees it, is an unruly amalgam of things—aspirations, tastes, physical states, responses to existing roles and norms, values, judgments, emotions, drives, beliefs, whims (1996a, p. 913). In his positive model, it is the interaction of these various elements that produce outcomes of a particular sort within a particular context. If one insists on using “preferences,” it must be understood from the outset that these preferences are constructed, rather than elicited, by social situations, in the sense that they are very much a function of the setting and the prevailing social norms (1996a, p. 913). In dispensing with the concept of preferences, he contends that with respect to social norms, choice among options is channeled by an individual’s benefit-cost calculation with respect to three factors: (1) intrinsic value, (2) reputational effects, and (3) effects on self-conception. He describes these as follows:

1. The intrinsic value refers to whether [independent of reputational effects and the individual’s self-conception] the option is fun, illuminating, pleasant, interesting, and so forth.

39 Sunstein (1996a, pp. 909, 910) states, “The idea of ‘preferences’ elides morally important distinctions among the motivations and mental states of human agents,” and that “when the idea of a ‘preference’ is unpacked, it becomes plain that the term is often too abstract and coarse-grained to be a reliable foundation for either normative or positive work.”
2. Changes in social norms can alter the effects of reputational incentives (and, thereby have consequences for self-conception asserting that obedience of law is built in large part on the perceived reputational consequences of law violation, noting that those consequences might be favorable rather than unfavorable).

3. People’s self-conceptions are very divergent, and each of our self-conceptions has many dimensions; for example, many of us may want not to be conformists, but also want not to diverge too much from what other people do and think. (Sunstein, 1996a, pp. 916 and 917)

Sunstein also stresses the point that social states can be far more fragile than is generally thought. Small shocks to publicly endorsed norms and roles decrease the cost of displaying deviant norms and rapidly bring about large-scale changes in publicly displayed judgments and desires. Hence, he focuses on what he terms “norm bandwagons” and “norm cascades.” He suggests that “[n]orm bandwagons occur when the lowered cost of expressing new norms encourages an ever-increasing number of people to reject previously popular norms to a ‘tipping point’ where it is adherence to the old norms that produces social disapproval” (1996a, p. 912). He offers the following examples: “if smokers seem like pitiful dupes rather than exciting daredevils, the incidence of smoking will go down; or if people who fail to recycle are seen as oddballs, more people will recycle” (1996a, p. 911). On the other hand, norm cascades occur when societies experience rapid shifts to new norms. He suggests that something of this kind happened with the attack on apartheid in South Africa, the rise of the feminist movement, and the assault on affirmative action (1996a, pp. 911–12).

Beyond his positive attempts to describe and better understand the role of social norms, Sunstein also believes, from a policy-regulatory perspective, that changes in social norms might be the best way to improve social well-being. Therefore the goal is to reconstruct existing social norms and to change the social meaning of action through a legal expression or statement about appropriate behavior. He recognizes that in the private sector so-called “norm entrepreneurs” attempt to change norms by identifying their bad/good consequences and trying to shift the bases of shame/pride, respectively. His main point, however, is that in many cases government deserves to have, and in any case inevitably does have, a large role in norm management. This enables Sunstein to conclude that “norm management is an important strategy for accomplishing the objectives of law, whatever those objectives may be” (1996a, p. 907).

The unifying theme in his normative theory of social norms centers on the expressive function of law— a term that he uses “to identify the function of

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40 “Laws designed to produce changes in norms will be my focus here” (Sunstein 1996b, p. 2026).

41 By which he means “the function of law in expressing values with the particular goal of shifting social norms” (Sunstein 1996a, p. 910).
law in expressing social values and in encouraging social norms to move in particular directions” (1996a, p. 953). He makes it clear that he is speaking of “the function of law in ‘making statements’ as opposed to controlling behavior directly” (1996b, p. 2024). Elaborating on the expressive function of law, Sunstein points out that many people support a particular law because of the statements made by law, and disagreements about law are not so much about the consequences (for example, the flag burning amendment) as about the expressive content of law (1996b, p. 2024). Rather than being concerned with laws that merely “speak,” his focus is on defending laws that attempt to alter social norms (1996b, p. 2028), in that shifts in social norms are a low-cost method of achieving widely or universally held social goals. When social norms shift, the expressive content of acts shifts as well, thus producing changes in reputational incentives that alter behavior in new directions, eventually resulting in norm cascades. As Sunstein sees it, a good deal of governmental action is and must be self-consciously designed to change norms, meanings, or roles, and in that way to increase the individual benefits or decrease the individual costs associated with certain acts, thus enabling him to conclude that “without understanding the expressive function of law, we will have a hard time getting an adequate handle on public views on such issues as civil rights, prostitution, the environment, endangered species, capital punishment, and abortion” (1996, p. 2029).

Eric Posner notes that the variety of types and forms of social norms requires that different models be used to understand and analyze the development and impact of these norms in different contexts. Posner, for his part, explores the link among symbols, symbolic actions, and norms. In doing so, he advances a model of signaling activity to analyze the role played by symbols in individuals’ behavior and beliefs, and how the legal system can influence and manipulate symbols. As Posner points out, symbols unquestionably exert influence on governmental policy, legal-economic and otherwise. Posner suggests that symbols matter because the attitudes that people take toward them reveal a great deal to others about those people’s character and influence the willingness of others to form cooperative relationships with them. The link between symbols and norms comes in because, according to Posner, the power attached to the symbol means that “people’s efforts to show respect for them

42 He writes, “[T]he close attention American society pays to the [Supreme] Court’s pronouncements is connected with the expressive or symbolic character of those pronouncements. When the Court makes a decision, it is often taken to be speaking on behalf of the nation’s basic principles and commitments. . . . [P]erhaps the expressive effect of the Court’s decisions, or their expressive function, better captures what is often at stake” (Sunstein 1996b, p. 2028).

43 For example, he suggests that “government might try to inculcate or to remove shame, fear of which can be a powerful deterrent to behavior. The inculcation of shame operates as a kind of tax; the removal of shame might be seen as the elimination of a tax or even as a kind of subsidy” (Sunstein 1996a, p. 913).

44 All references to “Posner” in the remainder of this section are to Eric Posner.
lead to significant forms of conformity that can be described as social norms” (1998b, p. 767).

Symbolic behavior is a normal and regularized part of life in society, and this symbolic behavior takes a wide variety of forms. For example, people “shake hands, applaud in theaters, salute the flag, wear stylish clothes, exchange wedding rings, bow, present gifts, observe diplomatic protocol, and show deference to superiors” (1998b, p. 767). Why, though, do people engage in these symbolic behaviors? Posner answers this question using a model of a “cooperation game,” where cooperation refers to any kind of cooperative relationship that can be modeled as a repeated prisoner’s dilemma, including business, family, and social relationships. The cooperation game approach suggests that people engage in symbolic behaviors because they want to induce others to cooperate with them, and they do so by sending signals. These signals show that they have a characteristic that they want the receiver(s) of the signal to believe that they have, but that the receiver is unable to observe directly.

The underlying motivation here is the presence of mutual gains from cooperation, accompanied by the problem that one can get burned if the other party cheats in a supposedly cooperative venture. Behavior is thus guided by the prospect of one’s needing to deal with other members of society when future favorable transactions need to be executed, but under conditions of uncertainty. Posner’s approach effectively posits norms as conventions that govern the behavior of individuals who are attempting to signal to the larger community that they are “good types” with whom to build productive long-term cooperative relationships. These signals are costly (sometimes more so, sometimes less so), but also give rise to associated benefits. Those who value the long-term gains from a cooperative relationship with others will invest in sending the signal, and the willingness to incur these costs will tend to provide evidence that one is a cooperative type.

In the resulting signaling equilibrium, several outcomes could obtain. The first and most obvious is a separating equilibrium, where “all the good types send the signal and match up with each other, and the bad types do not send the signal and either match up with each other or not at all” (Posner 2000, p. 19). That is, a separating equilibrium distinguishes the good types from the bad types. There may be times, however, when everyone sends the signal because the expected gains from doing so outweigh the costs for good types and bad types, giving rise to what is known as an active pooling equilibrium. In other cases, no one sends the signal because expected costs outweigh the gains for both good types and bad types—a passive pooling equilibrium.

In short, individuals comply and enforce certain social norms with a view toward developing long-run exchange relationships. The norms here are endogenous: they describe the behavior that arises in equilibrium. As Posner (1998b, p. 797) points out, “It is not that X punishes Y for violating a social norm; rather, X (and many other people) avoids Y because Y’s behavior
reveals to X that association with Y will not serve X’s interests. Although in
common speech we say that Y’s behavior violates a social norm, the punish­
ment is endogenous, not imposed by an external force.” The effect is that “an
important class of social norms arises from signaling games in which people
choose actions that signal loyalty to states and communities” (1998b, p. 797).
While people may engage in these behaviors because of certain intrinsic moti­
vations, in many other cases they will engage in these behaviors only to show
that they are loyal, giving it “the peculiarly empty quality of a symbol,” where
“people take little or no pleasure from the behavior, but engage in it for the
sake of reputation” (1998b, p. 797).
Thus, the signaling model provides yet another perspective on the relation­
ship between law and social norms. Laws and other forms of state action can
affect signaling equilibria in multiple ways: (1) it can affect the cost of send­
ing a signal; (2) it can affect the payoffs that senders and receivers receive
from cooperation; (3) it can affect people’s beliefs about the relative preva­
ience of good types and bad types in the population; and (4) it can affect the
payoff to signal construction to the norm entrepreneur or even construct a sig­
nal itself (Posner 1998b, pp. 778, 789). The result is that a change in legal
rules can give rise to a new signaling equilibrium, and the efficacy of the new
law can be determined by comparing the new signaling equilibrium with the
old one.45
Posner rejects the arguments of those who take the tack that social norms
are almost certain to be efficient in certain contexts—such as small groups—
arguing instead that efficiency is highly ambiguous a priori, and that efficiency
judgments cannot move beyond the situation- and circumstance-specific. In
fact, because norms tend to generate positive externalities, economic theory
would suggest that they will be undersupplied. These two indicators of social
norm inefficiency raise the question of government intervention to resolve the
inefficiencies. As with efficiency questions, Posner contends that “one can
make no presumptions” about whether intervention will make matters better
rather than worse. This, too, depends on circumstances and on the agents and
institutions doing the intervening (2000, pp. 176, 179).
The dependence of cooperation on the existence and form of symbols
gives the government an incentive to intervene and create or otherwise regu­
late these symbols. He says, however, that there are good reasons to be wary
of those pushing for state regulation of social meaning and of the very idea of
the state engaging in such regulatory efforts:
First, government officials do not stand outside the signaling game. They, like cit­
nizens, are prisoners of symbols when the symbols are sufficiently powerful. . . .

45 If the law changes the equilibrium from separating to pooling, the signal, obviously, dis­
ppears. Regarding the ambiguity surrounding efficiency judgments as between signaling equilibria,
see Posner (2000, ch. 10).
Second, the results of government efforts to change or sustain symbols, whether through legal devices or official exhortation, are inherently unpredictable. Thus, government efforts to change signals can backfire, leading to a strengthening of symbols that the government sought to change . . . or to reification of the desired symbol. (1998b, p. 798)

Posner goes on to point out that “when government efforts, whether deliberately or not, destroy or reify existing symbols, norm entrepreneurs will propose new symbols that may have worse effects than the old ones” (1998b, p. 798). Furthermore, rent-seekers may engage in wasteful competition in an attempt to use government as a means to convey their desired symbols (p. 796).

**LAW, ECONOMICS, AND SOCIAL NORMS AT WORK**

*The Coase Theorem Meets Social Norms*

In his book *Order without Law*, Robert Ellickson examines the empirical applicability of the Coase theorem by looking at actual cattle rancher and farmer disputes in Shasta County, California, a picturesque rural community in Northern California where cattlemen own and operate large family ranches. Also present there are retirees and other recent settlers who live on “ranchettes.” These ranchette owners maintain properties that are generally smaller than those of the cattle ranchers, and, while they may keep a few farm animals on the property as a hobby, for the most part do not make significant income from agriculture. Ellickson describes the relations of cattle ranchers and the ranchette owners on several fronts, including incidents involving cattle which stray from the ranchers’ property onto that of their neighbors or even onto the nearby highway, where cattle and drivers are often seriously injured and even killed in collisions.

Ellickson’s narrative touches on the history of range law, including the pressures to close the range that grew through the nineteenth and early twentieth centuries. This culminated in the Estray Act of 1915, an act that made owners of livestock in most of the state strictly liable for trespass damage. Shasta County commissioners, however, have designated part of the land as “open range,” meaning that the landowner whose property is trampled by trespassing cattle bears the cost of the damages, and other parts of the land as “closed range,” meaning that it is the rancher who must pay for the damage caused by his wandering cattle. Against this legal backdrop, Ellickson explored three different types of legal disputes: (i) Who bears the cost of damage caused by trespassing cattle? (ii) How are costs allocated for fencing property boundaries? (iii) Who pays for the damage in auto accidents caused by cattle wandering onto the highway? According to California law, the county’s designation of a
range as either “open” or “closed” is controlling only in the first scenario, that is, in the instances of cattle trespass. There is a separate California statute that governs the allocation of costs for boundary fences, and auto-cattle accidents are dealt with primarily through the standard rules of negligence regardless of whether the accident occurred in open- or closed-range territory.

After years of research, Ellickson concluded that the neighbors of Shasta County resolved their disputes without reference to the law, frequently in ignorance of the law, and sometimes in spite of the law. More specifically, he showed that the cattle ranchers and ranchette owners of Shasta County turned to informal norms rather than legal rules to resolve disputes. Ellickson demonstrated that resources were allocated in accordance with the established social norms of the community and, as such, controlled human interaction more directly than the prevailing law. It was the social norms, rather than the laws in place, that ultimately shaped their social order.

Of course, for our purposes here, what is important is the nature of those controlling social norms. Ellickson’s explanation for the effectiveness of these norms turns on an argument that these ranchers and ranchette owners in Shasta County have a “continuing relationship” and thus constitute a “close-knit group” (Ellickson 1991, p. 178). Here, “neighborliness,” and the “cooperation among neighbors” are important elements in the evolution, existence, and maintenance of social norms. This “close-knittedness” both arises from and gives effect to the dissemination of adequate information, reciprocal power, and ready sanctioning opportunities among parties to a potential conflict. That is, according to Ellickson (1991, pp. 177–78), “a close-knit group must be nonhierarchical; the informal power is broadly distributed among group members and the information pertinent to informal control must circulate easily among them.” In addition, he argues that a close-knit group must also have “credible and reciprocal prospects for the application of power against one another and a good supply of information on past and present internal events” (1991, p. 181). Thus, close-knittedness is contingent on the existence of continuing relationships among members of the group (1991, pp. 65–66, 168).

For example, in a cattle trespass case, the victim of trespass telephones the cattle rancher to inform him that his cattle are loose and doing damage. The rancher typically would thank the caller, often apologize for the harm, and then go round up his straying cattle. In disputes over fencing, which can be very costly to resolve, Ellickson discovered that a rule of proportionality governed behavior: if there was a shared boundary between two ranchers, the neighboring ranchers would split the costs of installing a fence and divide up the responsibilities based upon the number of cattle each owned, rather than engage in cash transactions. When there was a common boundary between a rancher and a ranchette or other non-ranch property, the norm of proportionality,
then, required the rancher to pay for and build the fence. In all of these cases, the problems were settled without reference to the law in place; indeed, changes in the law, which we would expect to affect who pays for the fence, had no impact at all on the distribution of costs.

In an extensive review of all facets of the interactions between ranchers and other residents of Shasta County, Ellickson came to the conclusion that “members of tight social groups will informally encourage each other to engage in cooperative behavior” (1991, p. 167). The norm that an owner of livestock is responsible for the acts of his animals thus exemplifies an “overarching norm of cooperation among neighbors” (p. 77). Such cooperation, he argues, maximizes the aggregate welfare of the members of a close-knit group (p. 167). In all, Ellickson maintains, farmers and ranchers achieve cooperative outcomes “by developing and enforcing adaptive norms of neighborliness that trump formal legal entitlements” (p. 4). These norms function as “nonhierarchical processes of coordination” (p. 5), processes that are central to his narrative of order—a basic legal function—the result of which is that neighborliness is shaped “beyond the reach of law” (p. 4).

**Social Norms and the Diamond Industry Cartel**

In an extensive analysis of the diamond industry, Lisa Bernstein (1992) explains how the economic performance of that industry is influenced by social norms that work in place of formal law. She observed that the disputes among members of the diamond industry were not resolved through the courts nor by application of formal legal rules enunciated and enforced by the state. Instead, firms in the diamond industry had organized their own system of private governance to perform monitoring and punishment functions. This governance system employed a norm-based mechanism of contract enforcement to deter breach and resolve contractual disputes. Equally important, it endured.

The DeBeers cartel distributes about 85 percent of the world’s supply of diamonds to four brokers who, in turn, during the course of ten viewing sessions held in London each year, sell rough diamonds to some 150 to 200 dealers, known as sightholders. Most of the U.S. sightholders are members of the

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47 This section simply draws on and presents an abbreviated restatement of the facts in accordance with Bernstein’s 1992 article. We distilled a rather lengthy article down to the three-page review contained here and, in doing so, have borrowed directly from her article so as to maintain and transmit her excellent and detailed analysis of this industry.

48 Janet Landa (1981, 1994, 1996) has undertaken a similar analysis of how social norms driven by a Confucian code of ethics govern contractual relationships among Chinese middleman traders.
New York Diamond Dealers Club (NYDDC), which comprises about 2000 sightholders, manufactures, wholesalers, and brokers. The cartel actively monitors all facets of the sale and distribution of the diamonds to the sightholders and controls the trade through a strict set of internal rules that are designed at once to facilitate trade and maintain the power of the cartel. For example, all diamonds must be paid for by the sightholders within seven days of acquisition. Because it takes roughly four months for a sightholder to turn a rough diamond into a cut and polished stone that can be offered for sale, the cartel provides financing for the sightholders’ purchases but does so under its own set of rules and via its own set of approved banks—one of which is located in the same building as the club.

Smaller dealers and brokers do their business on the NYDDC trading floor. The larger, more important dealers conduct their business in private settings but do go regularly to the trading floor to get a sense of where the market prices are.49 For the smaller dealers, the trading floor is the place where they can signal their trustworthiness, and it provides them with a secure place to make transactions. Much of the transacting process is structured by norms specific to the diamond trade. For example, when a buyer wants to make an offer to a seller, the diamond is placed into an envelop that is then folded and sealed in a precise manner. The date and the terms and conditions of the offer to buy are written on the envelop, and the buyer then signs the envelope across the seal. By convention, the offer is good until 1 p.m. the next day. If the seller wants to accept the offer, the deal is consummated with a handshake accompanied by the words mazel u’brouch. This creates a binding agreement. With this agreement in place, the parties then take the diamond(s) to be weighed and are issued an official weight slip listing the basic information on the nature of the agreement completed on the floor. A similar document is prepared when transactions are made in private offices rather than on the trading floor. These bills of sale are considered by the NYDDC to be definitive evidence of the transaction when disputes arise over the nature of the transaction, and place the matter firmly under the club’s jurisdiction, thereby exposing the disputing parties to club sanctions if they take the matter court.

As Bernstein points out, these handshake contracts have many advantages over formal, legal ones, mostly via their effects in reducing transaction costs. For example, they tend to reduce costs both by reducing risk associated with the transaction and eliminating costly, time-consuming negotiations over payment terms. The major transaction-cost-reducing function, though, comes through the reduction of costs of acquiring reputation-related information about other parties. Information on reputations is crucial to contract formation in markets such as this one, where contract enforcement depends on damage to reputation and social ostracism. People will be unwilling to deal with those

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49 The NYDDC does not record the price or volume of daily transactions.
who do not deal honestly if they know about this dishonesty, which means that negative reputation effects can be disastrous for one’s business. On the other hand, the secrecy norm with respect to those outside of the NYDDC is highly valued by club members. Because trade secrets may be revealed in civil courts, the parties to a dispute have a strong incentive to settle their dispute through club-level arbitration. In fact, as Bernstein notes, the preservation of the secrecy norm is one of the primary reasons why the industry has historically used extralegal agreements rather than relying on formal contract law.

All dealers agree, as a condition of membership, to take disputes between themselves and other club members to the club’s binding arbitration system. That is, members may not seek any redress through the courts; doing so can result in a fine or expulsion from the NYDDC. Here, the club employs transaction-cost-reducing mechanisms, including a mandatory prearbitration procedure where about 85 percent of all disputes are resolved. Those cases that are not settled through this prearbitration process are resolved in the more formal NYDDC dispute resolution bodies. If the club, for whatever reason, decides not to hear a case, the parties can seek remedies through formal law. Such is the extent of the extra-legal nature of this process that the NYDDC Board of Arbitrators does not even apply the New York state law of contract or its associated damage provisions. Instead, it resolves disputes based on the industry’s norms and trade customs, some of which are codified in their by-laws, others of which simply exist as norms among group members. Typically, parties found to have breached a contract or engaged in unethical conduct can be ordered to pay a fine—which may have compensatory and punitive components—or to make a donation to charity. Refusal to pay the fine can lead to your membership being suspended or revoked.

One of the most important elements of the industry centers on the posting of reputation bonds and “psychic/social bonds.” Reputation bonds are equal to the present value of the profit on future transactions that will not be realized if the promisor breaches. For transactions involving dealers who are not members of the club, the reputation bond is, effectively, the sole enforcement mechanism that avoids recourse to the courts. Moreover, while transactions among club members can be resolved through arbitration, the reputation bonds provide one avenue for the NYDDC arbitration panel to enforce its judgments among members. The less tangible “psychic/social cost bonds” are also effective enforcement mechanisms. When a so-called primary social cost bond is sacrificed, a breaching dealer’s ability to communicate information about his reputation and his ability to obtain information about new business opportunities may well be diminished. When a so-called secondary social cost bond is sacrificed, the breaching dealer may experience guilt, loss of self-esteem, and questions about trustworthiness and competence, as well as losing out on opportunities for pleasurable associations.

Thus, as Bernstein makes clear, while some of the success of the diamond
industry is due to the manner by which trust and reputation are mechanisms that facilitate commercial transactions, the enduring success of the industry has at least as much to do with the fact that reputation effects and social bonds have been used to create a system of social norm-based private law—one that both reduces the costs of transacting and allows most transactions to be consummated and enforced apart from the formal legal system.

**CONCLUSION: MARGINAL EVOLUTION OR PARADIGM SHIFT?**

The foregoing discussion illustrates how the analysis of social norms in the context of law and economics can enhance our understanding of the interaction between the domains of law and social norms and how this can be applied to the analysis of legal-economic outcomes. The goal of this research is to promote an increased understanding of how formal law and social norms serve separately and jointly as regulators of individual behavior and the implications of this for the fashioning of both laws and social norms so as to best accomplish society’s goals.

If one accepts the idea that the influence of social norms must be incorporated into Law and Economics, the question then arises as to the paradigmatic meaning of this for the field of Law and Economics. This raises the issue of whether the inclusion of social norms into a body of analysis so heavily dominated by rational choice theory constitutes a paradigm shift in the Kuhnian sense. Ellickson argues the affirmative case:

Kuhn’s framework can be applied to the situation of classical law and economics—the paradigm developed by Ronald Coase, Guido Calabresi, and [Richard] Posner and others in the 1960s and 1970s. . . . Under the Kuhnian framework, the thesis that classical law and economics is in for significant change could be stated in either strong or weak form. The strong version is that the newly discovered phenomena are anomalies that ultimately cannot be reconciled with the classical paradigm and will lead to its demise. The weak version of the thesis asserts that normal science within law and economics can accommodate these phenomena.

Ellickson favors the weaker version, suggesting that “law and economics is in for a time of turbulent normal science, not extinction,” and that the enormous surge in interest in social norms and related phenomena “promises to enrich” law and economics rather than signaling its demise (1998, pp. 539, 551, 537). Richard Posner (1998b, p. 565), on the other hand, disagrees with Ellickson, arguing that the inclusion of social norms into Law and Economics does not constitute a paradigm shift—strong or weak—but rather merely an extension of an ongoing progressive research program, “one that employs the same basic

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50 See Kuhn (1970).
paradigm, namely the theory of rational choice, of which both game theory and public choice can be viewed as extensions.”

A more comprehensive approach to Law and Economics that includes an analysis of social norms still needs to be worked out. Laws and social norms are both key components of the social, political, and economic fabric against and within which economic activity takes place. Systematically ignoring either one of these can lead to faulty predictions of expected legal-economic performance followed by cries of frustration over “unintended consequences.”

There seems to be an emerging consensus—or at least a strong majority view—that (i) the structure of rights, rules, and legal doctrines; (ii) technology; and (iii) habits, customs, mores, and social norms all affect behavior and performance—in the case of habits, customs, mores, and social norms, by inducing certain patterns of preference formation that directly affect behavior. In fact, it is fair to say that these concerns are now prominently reflected to some degree in all of the major schools of thought surveyed in this book.

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EPilogue

Law, technology, and social norms are all important factors in driving economic performance. If the reader has taken anything at all from this book, we hope that it is a healthy appreciation for the complexity of these interrelations and the significant contributions that all of the various schools of thought surveyed here make to our understanding of them. Our discussion has highlighted certain of the fundamental disagreements that exist between schools—those over efficiency as a workable or ethical standard and over the usefulness of the rational-actor model being foremost among them. These differences across schools, however, and the “competing perspectives” aura that they bring to the discussion are vastly outweighed by their respective horses for courses utilities. Each school of thought—indeed, even each of the factions within each school of thought—trains a somewhat different lens on the questions that we posed early on in chapter 1, namely, “What is the law?” “Where does the law come from and how does it acquire its legitimacy?” and, “In what direction shall we change the law?” As such, each emphasizes its own mode of reasoning and maintains its own stance on issues in legal-economic policy and, in doing so, brings out different facets of legal-economic problems and their potential resolutions.

From a more practical perspective, the influence of law, technology, and social norms is such that when policymakers are trying to attain a particular policy outcome, they must be careful not to fall victim to relying exclusively
on just one of these three major factors in proposing remedies. Each of these factors creates its own particular perspective on a problem and hence, its own particular agenda for dealing with that problem. For example, in policy debates, it is not all that unusual to witness proponents of “the technological fix” arguing for more science, technology, and resources to “build in” the remedy being sought. It is also not unusual to find proponents of the Chicago- and Virginia-based approaches to legal-economic policy advocating for market remedies (typically under the banner of “deregulation”) as a singular basis for policy. And finally, once the door is open to changing social norms, one confronts more and more the social norm, NGO preachers calling for us to “do the ‘right’ thing.”

As various legal-economic issues arise, it is clear that these factors are often in conflict and, even when they are not, most legal-economic issues are sufficiently complex so that it makes relying on any singular approach problematic. We believe that all singular solutions must be rejected whether with regard to technology, social norms, or among the schools of thought within Law and Economics. The quest must be to understand the role that social norms play in helping to order society (or social groups within the society) together with the role played by incentives promulgated by the state-sanctioned law, together with the impact brought on by changing technology, and the ways in which the triad of law, social norms, and technology interact to affect economic performance (broadly conceived). This, in turn, requires a broad-based, or eclectic, approach to Law and Economics.

We began this book by saying that we intended to provide an outline of the principle contours of the various approaches Law and Economics, and that we were not going to attempt to make judgments among them. This approach is perhaps less than comforting to those who want to be given “an approach” or “the best approach” to doing Law and Economics. The fact is that there isn’t such a thing. Each of these schools of thought is far too narrow in scope to do justice to the breadth and totality of the interrelations between legal and economic processes. Taken together, however, they unlock the black box of legal-economic relationships that had so long been ignored in the development of economic and legal thinking. It may be true that, as many critics of Law and Economics have argued, law is far too important to be left to the economists. It is also however, far too important to be left to the lawyers, the ethicists, the political scientists, or the sociologists. Holmes was right: in the legal arena, the man of the future really has turned out to be “the man of statistics and the master of economics.”

Both economics and the law are that much richer as a result.

51 As Sunstein warns, however, once norms are introduced into the mix, “a reference to social norms will become a conclusory response to any apparently anomalous results” (1996b, p. 945) and of this, we must be careful. It has also been argued that this same sort of vacuous thinking has victimized policy-making with regard to the ubiquitous use of the concept of transaction costs.

52 Holmes (1897, p. 469).