

Norms and the Power of Loss: Ellickson's Theory and Beyond

Comment

by

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1. Introduction

Why are there not just laws but also social norms? Under what circumstances do they arise? What is their content? These are crucial questions about norms and especially the third, about the content of norms, has rarely been asked and never answered in a satisfactory way. Now there is a brand new theory on the market: Ellickson's theory of norms (ELLICKSON, [1991]). It also comes with a detailed empirical case study of informal social control (in Shasta County, California). Does it answer these questions, including the third? Where does it improve on previous theories? What new lines of inquiry does it open, and where could it be pushed further? In the following, I will try to answer these questions. Yet most of my attention will be paid to the last: where could it be pushed further?

Ellickson's theory of norms is thoroughly steeped in the importance of the new convergence between economics and sociology. He clearly sees the advantages and blind spots of each discipline. "Because their vision of reality is so rich... sociologists and their allies have been handicapped because they do not agree on, and often don't show much interest in developing, basic theoretical building blocks." (p. 147) By contrast, economists "although often disturbingly blind to realities – are clearer, more scientific, and more successful in building on prior work." (p. 147) In addition, both disciplines have important substantive blind spots. "Just as microeconomists tend to take consumers' tastes as given and limit themselves to the study of market processes, so sociologists tend to work not on what norms are but on how norms are transmitted." (p. 155) Although the sociological explanations are thus seriously incomplete and greatly in need of more formal modelling, they are not as one-sided as the "law and economics" theories which by and large grossly exaggerate the power of the law. "Most people know little private law and are not much bothered by their ignorance," Ellickson observes (p. 146). Most authors of the sociological "law and society" school sensibly perceive the dual influence of law and norms on behavior. With regard to his own empirical research, Ellickson admits that the

law and society scholars, because of their understanding of the importance of informal control, would be better able to predict the essence of what he found in Shasta County. Yet, sociologists have hitherto been unable to specify a mechanism of how social control actually works. Providing the specification of such a mechanism (with the aid of economics) is clearly Ellickson's aim. Let us have a closer look in order to see whether he has succeeded.

2. Ellickson's Theory of Norms

The combination of economics and sociology can be seen from the outset. Ellickson's central hypothesis is taken from economics: the idea that rules are instruments for welfare maximization. However, with the aid of insights from sociology, he sharpens this hypothesis considerably by maintaining that it only holds for certain rules, viz. norms, and only in a particular context: close-knit *groups* developing instruments of social control in workaday affairs. This context allows him to make the first important step toward specifying the content of norms: it derives from the fact that norms are part of a system of social control. A group is close-knit if group members do not differ much in informal power and information on behavior can circulate easily. Because much of a group's welfare depends on cooperation, workaday behavior in a close-knit group includes control of one's own and other member's behavior. It must either be discouraged (punished), or left alone or encouraged (rewarded) and norms define how conduct by group members is to be treated. Norms do add something to the factual influence attempts, but what is it? The standard sociological view of social control is that norms add layers of control. People do not just sanction other people's primary behavior but also their sanctioning behavior. Ellickson mentions this aspect but stresses a different one. As a lawyer, he points to the fact that many norms pertain to the administration of social control. This yields the first answer concerning the question about the content of norms. Behavior is either acceptable as it is, in which case it is to be left alone, or it warrants interference (social control) in which case it should either be encouraged by rewards or discouraged by punishment. There are norms that control primary behavior; Ellickson calls them *substantive* norms. But the majority of norms deal with secondary behavior: behavior with regard to the administration of norms. *Controller-selecting* norms specify who should do the controlling in any particular instance of deviance from the substantive norm. The most important alternatives are: informal control or the law. These norms, like all others, are governed by welfare-maximization. Using the legal machinery may estrange the disputants so that there are high relational costs. On the other hand, informal control may leave too much room for disagreement and thus high transaction costs, especially when the stakes are high. Thus either informal control or law will be optimal in a particular situation. Assume that after the infringement of a particular norm the controller-selecting norms

point to informal control: the question then arises as to how it should be punished. This is specified by *remedial* norms. These norms contain a sequence of control efforts with gradual escalation. For example, at first, there is a sequence of self-help. The deviant must initially be informed that the act had been discovered, giving him a chance to take remedial steps himself. If this does not help, negative gossip may be circulated about him. If this still does not help, physical intervention may be the appropriate third step. If this is still not enough, third parties (organizations or the law) must be brought in.

In order for the first step in remedial norms to work, there must be some indication how the deviant can make up for what he has done and for that purpose, there must be auxiliary rules that measure the amount of damage that arises from the deviant act. These rules are also necessary for calibrating the amount of punishment. Ellickson groups them under the remedial norms. Due to bounded rationality, these rules will be rough which means that welfare maximization must be understood with a grain of salt.

There are also *procedural* norms which "govern a member's duties to transmit to other members of the group, information whose circulation would help minimize internal disputing." (p. 230) For example, in a close-knit group, you have the duty to transmit information of antisocial behavior of other members, thereby helping in the second self-help phase (with gossip) and helping to keep up the cooperation of others who fear a bad reputation. Another example: if you know in advance that you will not keep to the rule, it is your duty to warn others in advance, so that they can mitigate the damage. Thus if you know that you will be late, you are expected to tell the other in advance.

Another category Ellickson calls *constitutive* norms. They pertain to the maintenance and control of group membership. For example, there may be dress, speech or etiquette rules which help identify members, and screening devices may weed out uncooperative new members at the start.

Each kind of norm is governed by the principle of welfare maximization of the group which means that the norm is being chosen in such a way by the norm maker(s) that deadweight (i.e. avoidable) losses and transaction costs are being minimized. For example, who should be made responsible if a rancher's cattle damages a farmer's field. According to the hypothesis, responsibility should be placed with the cheapest cost-avoider because both deadweight losses and transaction costs are minimized that way. In Shasta County, Ellickson's region of research, cattlemen are currently much more familiar with barbed-wire fencing than the ex-urbanite small farmers of the region, creating large deadweight losses if the small farmers are responsible; in addition a cattleman can act on his own while the potential victims of loose cattle are numerous and would be confronted with high transaction costs for joint action. The rancher should thus be responsible in this case, and indeed he is (see ELLICKSON [1991, 187]).

The crucial questions can now be answered in the following way. Rules are instruments of control. These instruments are sensitive to cost effectiveness. There are contexts in which informal control is more cost effective than formal

control by law. Norms arise from social forces in a close-knit group with regard to workaday affairs. Regarding the content of norms it can now be said that in order to find the content of substantive norms in close-knit groups, search for possible deadweight losses and transaction costs; then search for objectively optimal rules that actually minimize deadweight losses and transaction costs. In this way the content of the current substantive norms will be found. Then there will be norms about the administration of social control. There are recognizably different categories of these norms and in each case, the hypothesis predicts that those alternatives will be realized as norms that minimize deadweight losses and transaction costs. There is, of course, much more that is worth-while in Ellickson's book, but this account does offer the gist of his theory. How good is it?

3. Evaluation of Ellickson's Theory

The strong points. Because of the ingenious combination of insights from economics and from sociology, Ellickson's theory of norms is in my judgement the most complete theory of norms to date.¹

Two points stand out as particularly interesting. First of all, he places norms into a context of social control, i.e. self-help, in informal groups. This helps him to generate many interesting substantive hypotheses about the system of social control and the rules necessary to make it work. To my knowledge, economic theories (and by and large all rational choice theories) of norms have so far failed to incorporate such a detailed context of social control. Second, because of this control context, Ellickson realizes that norms necessitate some kind of objective measure of value and that this value cannot be restricted to material advantage (i.e. to wealth). For this reason he insists on welfare maximization rather than utility maximization, and he does not speak of efficiency and other terms that are tied to subjective evaluations in economics. Nonetheless, he retains the logic of an efficiency explanation of rules with all the analytic power that goes along with such an approach.

It is interesting to note that the categorization of nonsubstantive norms corresponds to the famous AGIL scheme by PARSONS [1970]. This scheme subdivides every system into four functions: Adaptation (dealing with the possible interchange of this system with another system), Goal achievement, Integration and Latent Pattern Maintenance. Social systems have rules pertaining to each of these functions. Even without extra explanation of the terms, the parallel can be clearly seen. Controller-selecting norms belong to the Adaptation function of the system of social control in a close-knit group; the remedial norms are tied to the Goal of the system to achieve of cooperation in the face of deviance; the procedural norms help minimize internal disputing and

¹ It is also more complete than Coleman's recent elaboration of a theory of norms (see COLEMAN [1990]).

thus foster Integration; and the constitutive norms govern the maintenance of the patterns that are constitutive for the system. Ellickson could profitably learn from Parsons' more elaborate analysis of social systems, but the important point is that the efficiency framework allows him to do more for the explanation of norms with his classification than Parsons could do with the AGIL scheme.

The weak points. The dynamic part of the theory stems from the hypothesis of welfare maximization of the group. However, he does not supply any mechanism by which this result is supposedly achieved. In this sense his theory is thoroughly anchored in the functionalist tradition of efficiency explanations (see GRANOVETTER [1985]). Not surprisingly, he finds that functionalists are "on the right track" (op. cit. p. 150) and that he cannot criticize them for not supplying a mechanism of the evolution of cooperation since he does not do so himself (p. 152). However, without a micro mechanism that supposedly produces welfare maximization, it is not possible to predict under what circumstances this maximization would not occur, nor is it possible to say how the norm production process will respond to changes in the density of the group. Finally, the question of the content of norms must remain largely unanswered if we do not know exactly what generates the norms and what might there be that keeps norms from being generated. In the following, I will sketch a theory of norms quite sympathetic to that of Ellickson but with a much heavier emphasis on relational aspects (and the micro theory that goes along with this emphasis).

4. Beyond Ellickson: A Relational Theory of Norms

Ellickson has a good grasp of what other theories on norms exist and he responds to them quite adequately. For this reason, I will not attempt to assess his theory in the light of what others have done. Rather, I will attempt to point to a way beyond his theory by sketching a mechanism of cooperation, thus adding more micro theory than Ellickson has done, in the hope of getting a better grasp on the conditions under which order without law is likely to appear and the different faces this order may have. In doing so, I draw on my own previous work on this subject.²

Sharing. The important issue in small, interacting groups is not welfare maximization. Rather, it is that this group shares to some degree in production and/or consumption. The clearest example may be a group of farmers who share purchase and use of a combine. Before there were insurance companies, these farmers probably also shared risks of illness and bad harvest. Neighbors most likely also share some risks but they also share space and air.

² See Lindenberg [1982], [1983], [1986], [1992], [1993].

Sharing typically creates positive as well as negative externalities. The cost of the combine can be split, that is a positive externality. But the joint use also creates negative externalities. Having others help you when you are in need is a positive externality of their membership for which you have to pay the price of helping if they need your help. But if they do not live carefully and thus increase their health risks, they exert negative externalities on you. Neighbors also have to deal with things that move over space like animals, or things that move through the air like sights, sounds, smells and smoke: all possibly positive or negative in their external effects. It is crucial that when we talk about the generation of norms that we always insist on a context in which we have a *combination* of positive and negative externalities. Only this combination will prevent negative externalities from splitting up the group if there are exit options and prevent them from physical violence when the exit option does not exist, as is the case with people locked into one prison cell.

4.1 Various Kinds of Rules

Sharing rules. The most basic rules in such a group are rules that regulate the joint production or consumption (not the negative side effects). Thus, for the farmers, it is rules about cost sharing and rules concerning the timeshares for using the combine. In the case of neighbors, it is rules on property, especially delineating common property and allocating private property. When risks are shared, basic rules concern helping the other in need. Let us call all these rules *sharing rules*. How do these rules come about, given they are not imposed from the outside (as property rights often are)? Is it welfare maximization that governs this process? At this point, I must postpone the answer until we have established some more aspects of the rulemaking process.

Relational concerns. Even if farmers paid their shares and strictly observed the allotted times for use of the combine, their joint use of the combine would still create problems. For example, after using the vehicle, it is dirty and possibly in need of repair, greatly inconveniencing the next user if not cleaned and repaired by the previous one. There are likely to be many negative externalities. The view that norms come into existence in order to mitigate negative externalities has been the economists' major contribution to the explanation of norms ever since the influential paper by DEMSETZ [1967]. It is also the background assumption for Ellickson's theory. I do not want to deny that this hypothesis is correct. However, I believe that it greatly exaggerates the degree to which specific negative externalities are mitigated by norms. The more is being shared, the more likely it is that not all negative externalities cannot be enumerated and anticipated and dealt with *ex ante*. Like incomplete contracts, sharing rules create *ex post* uncertainties, and as with incomplete contracts these uncertainties must be dealt with in a relational way. If the future is too contingent to cover each possibility by a norm, then I want to be as sure as I can be that each person in the sharing group will choose a cooperative alterna-

tive when problems arise. How do I do that? Everybody in the group is presumably keenly interested in receiving social approval from other members of the group (see LINDENBERG [1986]) and this is so important to them that withdrawal of social approval in a group is a strong sanction. Choosing a cooperative alternative, especially where there is no explicit prescription to behave that way, is more than just cooperating in this particular case. It is also a way of *signaling* to the others that I am the kind of person who is interested in maintaining a relation of mutual social approval.³ What follows from this reasoning is that much cooperative behavior consists of relational signals in situations where clear prescriptions as to how I should act do not exist.

In fact, Ellickson's empirical work is full of stories of relational signaling. For example, he observes that splitting benefits or burdens in equal fractions "is a weak signal that the members are of equal status, a message that itself tends to promote mutual respect and future cooperation." (Ellickson [1990, 202]) In-kind transfers for retiring informal debts are frequently observed in Shasta County and Ellickson calls it a "norm" which "repeatedly puts members through the ritual of signaling that they are in solidarity rather than at arm's length." And he goes on "when one ranchette owner's goat ate his neighbor's tomatoes, the goat's owner responded by helping to replant the tomatoes, not by sending a check. These sorts of responsive gifts not only redress debts but also send a much-valued message of personal trust." (p. 235) The theorizing behind this is really about the workings of relational signals rather than welfare maximization of the group and he stresses this by adding "Fellow-feeling seems more likely to arise when members are seen to act out of friendship, not out of a need to scratch each other's back." (ibid. p. 236) If norms could cover all contingencies of negative externalities that arise why should there be "fellow-feeling"? Why should there be reluctance to admit to exchange and scratching each other's back? And under what circumstances should this reluctance be particularly strong? In another part of the book, Ellickson himself ventures the guess that "when parties are *intimately* close-knit... contracting may not be in their interest. The arm's length negotiation of a contract can pollute the atmosphere of a close relationship by implying that the parties don't trust each other enough to rely on informal exchange." (p. 247) For this very reason invoking the law rather than informal social control is a negative relational signal and people in Shasta County agree: "Being good neighbors means no lawsuits." (p. 251) Litigation is only expected for parties "who lack the prospect of a continuing relationship." (p. 274). Why is this so? If it were because of a cost advantage of informal control, it would fit the welfare maximizing hypothesis. But Ellickson does not invoke this hypothesis here. Why does "atmosphere" play a role to begin with and why does being "intimately" tied exclude formal-contracting or adjudication by a court? There is no answer in his theory because

³ Relational signaling can also explain relevant aspects of labor relations, from the opening offers in wage negotiations to "efficiency" wages (see LINDENBERG [1993]).

relational signaling only comes in through the back door. Worse, the only micro mechanism he does offer as possibly generative for welfare maximization is an “even up” strategy which people follow by attempting to square mental running accounts in indebtedness with other players (p. 225 ff). If this strategy was the major way in which welfare maximization came about, then there should be nothing wrong with the explicit idea of scratching each other’s back. I will come back to this point.

Externality rules. There clearly are not just relational signals but also *rules* that deal with negative externalities. However, these rules are not necessarily “norms” in the sense of ‘sanctioned behavioral pre- or proscriptions in informal groups.’ One important group of such rules is directed not at mitigating negative externalities but at preventing them from arising, avoiding them. They aid the *recognition of negative externalities*. For example, “fish and guest stink after three days” conveys to those who might not know that one can easily overstay one’s welcome. Of course, recognizing potential negative externalities before they have occurred is a way of dealing with them, and yet these rules differ from the norms talked about by Ellickson. Other, related rules pertain to relational signals. What behavior will signal interest, and what, disinterest, in the relation? As we have seen, taking people to court or repaying certain debts in cash may signal a lack of interest in the relationship although in other respects it is correct behavior. The sequence of control efforts referred to above can also be seen as rules about relational signaling. If the other is a member of the group, at first signal to him that you believe he is interested in the relation *although* he has just done something that does not look like it. If his response to that signal is relational disinterest, then choose a remedy that might also drive home the message how important it is to be interested in the relations around you. If this signal does not have the desired result, forget the whole thing or escalate to physical or legal means. In both cases you may end up with a member who is not interested in the relations. Many of Ellickson’s constitutive norms belong in this category of externality rules.

A third group of rules under this heading are rules identifying the *producers of externalities*. This includes the classical question of tort already posed by Coase. For example, if my cattle grazes on your land, was that because I did not watch my cattle or because you failed to fence your field? Ellickson calls the rules that would answer such questions “substantive norms.” Again, they do not deal with the mitigation of externalities but with the identification of the producer, which is often a precondition for remedial action. Ellickson maintains that the residents of Shasta County apply a strict liability interpretation of this question. In a legally “closed range,” the animal owner is strictly liable for trespass damage. In a legally “open range,” the animal owner is never liable (p. 48 f), even though the law itself is much more nuanced and invokes rules of negligence. The theory of relational signaling would have predicted something else: there is no strict liability rule as long as relational concerns have the upper hand (which they might not have when stakes are high. See below.). If your cow

happens to eat my flowers, I do not hold you strictly liable and I will not claim my flowers because that would be a negative relational signal (see above). Rather, I will interpret this as an accident, help you get your cow back and also hope for a signal from your side that indicates you are still interested in the relation. When stakes are high or the accident happens frequently, then a rule about who is the producer of the negative externality may indeed apply. This rule is probably based again on the logic of relational signaling. How can I interpret the fact that your cow keeps eating my flowers? I search for hints about signals and if a very prominent category that might bear on the signal question in this context is "open" versus "closed" range then I might use this category to solve my problem. More, if I know that you think in the same way then I am sure that you signal disinterest in the relation if your cow keeps coming back. By contrast, welfare maximization would make the principle of cheapest cost-avoider the basis of deciding this rule. While it is possible that relative costs of avoiding the damage might influence the signaling rules, it is very unlikely that such principles would override relational signaling. If this is true, then the welfare maximization hypothesis is just a bad approximation of a more complex micro process (or it is a complete tautology in the sense that everything that comes out of a close-knit group must be welfare maximizing). There is some evidence in Ellickson's book for this very point. He states that at times the strict liability norm clashes with another norm "that holds that rural residents should put up with ('lump') minor damage stemming from isolated trespass incidents. The neighborly response to an isolated infraction is an exchange of civilities." (p. 53) If norms can clash and we don't have a theory to say what the outcome is, how can we be sure the outcome is welfare maximizing?

Mitigating rules. There are of course also the kinds of rules that mitigate negative externalities. Why are relational signals not enough? Basically they would be if in all cases a group could live with the inevitable variance you get in relational signals. For example, if the rule is "repay this kind of debt in kind" (a rule about a relational signal) then one person may help plant tomatoes, another might bring a basket of pears from his own orchard, a third may help with digging a ditch around the patch of plants. Here, it is not so important what is being repaid as long as it is roughly equivalent. In other cases, however, it is more important that people do the same thing when dealing with a particular negative externality. For example, when people share small living quarters, it is quite important that the joint living room is relatively free to move about in. What is the relational thing to do when one of you have a guest (which inevitably causes negative externalities)? Should everybody join in, or should you take him upstairs, or should you sit in a corner and talk quietly? There is no obvious signal and thus, no matter what you do, you might be giving the wrong signal. In such a case it is in your and everybody else's interest to agree on a preferred way of dealing with guests. It is not easy to find a good example of this kind of norm in Ellickson's account of Shasta County, although it is supposedly the major kind of rule explained by economic theory.

Metarules. The more important it is that people behave cooperatively, the more likely that there will be rules on a metalevel about behaving in such a way by having a cooperative attitude (i.e. signals), keeping promises and sticking to rules. Ellickson acknowledges these rules as well, calling them “aspirational statements,” but he does not incorporate them into his categorization of rules.

4.2 Kinds of Solidarity and the Power of Loss

So far, we have identified relational signaling as the major mechanism of cooperation. What is still lacking is more detail on the question: what drives sharing rules and what drives rules about relational signals? For reasons of space, I will have to be quite succinct about these points, but elsewhere there are more elaborate expositions (see for instance LINDENBERG [1992] and [1993]).

Loss. A few months ago, I witnessed the economist Oliver Williamson asking the psychologist David Kahneman what he considers to be the most important aspect about human behavior. Kahneman replied: the asymmetry between gains and losses. Kahneman has also argued this asymmetry, which is against standard micro-economic theory, in numerous publications. In my own work I have made extensive use of the relative power of loss, including its power for the generation of rules and signals. The basic idea is this: because people react quite vehemently to loss (and most certainly, they withdraw social approval), others around them learn quickly to accommodate this fact. Loss generally leads to “overreaction” for which the costs of the reaction exceeds the original value of the loss. If I want social approval and other goods from another member of the group, I must avoid being seen as the source of loss. In bilateral transactions, this means that I have to make sure the other does have the feeling of getting at least as much out of the transaction as he put in, in the rough units of social exchange rates. This is the rock bottom mechanism of rule formation and relational signaling. On its basis, equity and reciprocity arise spontaneously as externality rules out of the experience of reactions to loss. Sharing rules must also comply to this mechanism. There is plenty of evidence in Ellickson’s study about this importance of loss avoidance. For example, Ellickson observed a general pattern of gradual escalation of force against unresponsive deviants. In fact, this pattern was the major feature of what he called “remedial norms.” Why would there be such a pattern? In order to maximize the welfare of the group? Ellickson himself offered a different explanation: if I overreact to somebody’s deviant behavior, he will feel he has been made to pay more than he got for the deviant behavior and react forcefully to the loss, which, in turn, will get me to overreact, etc. (p. 220).

Different kinds of relations. The more that is being shared and the more important the goods that are being shared in a group, the more important is the cooperation of each of the members and thus the more central the relational aspect and the weight of the signals. This will have at least three crucial

consequences. First, the importance of the individual will be small in comparison to the importance of the group; this is so because the individual's non-conformist wishes would be so loss producing for the others that the wishes themselves seem either irrelevant or threatening. Sometimes this is also referred to as a group-centered orientation. Second, there is a considerable willingness to consider the other members actual or potential loss, even if one is not the source of it, leading to a need orientation. If you are needy, I should help you. Third, the more important sharing is, the more important it is that you behave cooperatively even if no one can observe you. For this reason, if there are children in the interacting group, they will be taught to learn to approve and disapprove of their own behavior as well (what Adam Smith called the 'impartial observer'). Let us call this kind of group (or network): *strongly solidary*. The crucial features of strongly solidary groups has already been captured in the literature. Let me repeat them here. In strongly solidary groups, members help other members who are in need but they discourage trade and other activities that emphasize individual accounts inside the group, and they are likely to treat members of other groups as pure outsiders for whom none of the relational signals are applicable and none of the cooperative rules apply. Because individual differences are insignificant unless they involve some difference in need, there is a strong emphasis on equality vis-a-vis the group which takes over from equity and reciprocity considerations (see SAHLINS [1972]). This is what Max Weber described as the original state of nature: strongly solidary groups acting against each other (see LINDENBERG and DE VOS [1985]), Ellickson refers to strong solidarity as being *intimately close-knit*, but he has left it at that and does not elaborate on various kind of close-knittedness (p. 247). He also mentioned degrees in emphasis on socialization of self-monitoring but he did not relate these differences to aspects in his theory (p. 245f).

By contrast to strong solidarity, if little is shared or if what is shared is of little importance then the major orientation is toward gain. Relational signals then mitigate pure gain maximization on the individual level but the orientation itself is not dominated by the relational aspects as is the case with strong solidarity. For this reason, equity and reciprocity are not displaced by general equality and specific need differences. I call this kind of structure *weak solidarity*. Clearly, the relational signals in the two kinds of groups (*both of them close-knit in Ellickson's sense*) are different. In the context of strong solidarity, signals must refer to group membership as such rather than to bilateral relations while the opposite is true for weakly solidary groups. For example, in strong solidarity, I must signal to the others that I am a reliable member of the group. In weak solidarity I signal loyalty to the relation and, perhaps, via the relation, a loyalty to the group as a whole. Also, not being sensitive to loss not related to the transaction does not signal relational disinterest in a weakly solidary group while it signals disloyalty in a strongly solidary group.

5. Conclusion

It seems to me that Ellickson's theory constitutes a real advance by combining a social control context with rational choice. However, his theory provides too little micro process and therefore overestimates the importance of norms for informal social control (just as he claims that Coase has overestimated the importance of law). It also reduces his ability to predict the content of norms although that was his expressed aim.

The theory of relational signaling and the loss-driven theory of rules that is associated with it stresses first of all the sharing context as generative for social control. On this basis, it identifies relational signaling as the major instrument of social control in sharing groups. In analogy to the impossibility of closure of incomplete contracts, the theory argues that few of the ex post negative externalities can be specified sufficiently to cover them with an explicit norm. Rather, what counts is the signal that a person cares about the relation with others and thus would not do anything to jeopardize this relation. There is another reason why norms in the conventional sense of "rules that mitigate negative externalities" are overrated. Most of the rules in informal groups regulate sharing, the recognition of externalities or the choice of signals. Rules for the mitigation of externalities would only arise if a specific reaction is called for that does not allow the variance normally observed with relational signals. Thus this kind of norms only covers the exception to relational signals.

According to the theory offered here, the entire micro process of signal and rule creation is governed by the fact that people react much more vehemently to losses than to gains. Loss avoidance is thus each individual's strategy in a group, leading to rules and signals that serve this function. However, loss has a different meaning in strongly and in weakly solidary groups. In strong solidarity, loss pertains to non-relational reference point which indicate loss as deficit (need). In weakly solidary groups, loss pertains only to the input/output relation in bilateral transactions. Clearly this leads to different signals and rules in the two contexts.

In sum, it seems worth-while to trade in the hypothesis on welfare maximization on the group level for a more detailed process model on the individual level, even though the results may at times be similar.

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