

What sustains market societies as open access societies?

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Introduction

It is no trivial question how market societies come about. For example, it is not easy to answer the question how Russia can be turned into a market society (see Stiglitz 2002). However, there is yet another question that may turn out to be even more challenging: How can market societies (with their open access to markets) be kept from slowly reverting back into what North et al. (2005) call "a natural state society"? A natural state society is one in which economic organization is mainly built around *personal* relationships and rent seeking, with limited access to both economic and political markets. Rent seeking is an influence activity (such as lobbying or bribing) that tries to get politicians or regulators to make decisions favorable to oneself, or that tries to directly distort prices in one's own favor or to reduce competition (say, through a cartel). North et al. argue that natural state societies are able to create complex social and economic organization, with exclusive property rights and considerable technological development. Yet, their argument continues, these societies are strongly resistant to fundamental changes in the social order, especially changes that are necessary to reap the fruits of the potential of technological developments. What North et al. call "the open access society" is characterized by open access to economic and political markets (which implies *impersonal* exchanges) and legal institutional/organizational structures (such as third party contract enforcement) that support a wide variety of organizational forms. The latter is basically the neo-classical model with an added understanding of the importance of institutions.

I believe that the question posed by North et al. how market societies can be sustained against the tendency to revert back into a natural state society, is highly relevant and it has not yet been answered. In this paper, I would like to address this question in the sense that I would like to speculate about the conditions of sustainability of market societies. I will argue that the idea that impersonal exchanges need to be solely brought about by impersonal incentives is flawed. Impersonal exchanges need to be flanked by relational contracting and by bureaucracies both of which will not work well with a strong emphasis on impersonal incentives. I will also argue that there are endogenous instabilities in open access societies other than monopolists and that economists actually reinforce these instabilities rather than curb them as long as they are unable to deal with the flanking arrangements for impersonal exchanges. Richter (see for example Richter 2002) is next to North one of the few economists who have been active in promoting a broadening of economic theory so that it would be able to deal with such sociological aspects.

The importance of personal relationships and of bureaucracies for open access societies

North et al. made progress compared to the usual analysis of rent seeking by differentiating between two modes of interaction (personal and impersonal) and by arguing that the personal mode is a priori more stable than the impersonal one because evolutionary pressures have hardwired a predisposition for personal exchange. Thus, impersonal relations (according to North et al. necessary for an open access society) are inherently precarious. They must be wrought from the iron grip of a genetic predisposition through the work of institutions. This, in turn, makes open access societies constantly vulnerable for slippage into the natural state since any slackening of institutional control will start the process of displacing impersonal by personal exchange relations. Even though this analysis is a welcome advance over the standard treatment of rent seeking, it does not go far enough. I will try to show that their dichotomy of personal/impersonal relations is too rough to do the job even though it is rooted in a long-lasting and prestigious sociological tradition of similar dichotomies (such as "status versus contract societies" (Maier), "community versus society" (Toennies), "ascription versus achievement oriented societies" (Linton), and particularism versus universalism (Parsons)). Off-hand there are two objections. First, from all we understand right now about complex market societies, it follows that even the best running, low rent seeking exemplars, cannot be well characterized solely by impersonal relations. Given incomplete contracts, there must be trust relationships that cannot be sufficiently stabilized by third party contract enforcement alone. Second, there is an important difference between gain-based and obligation-based impersonal relationships (see Lindenberg 2001). For example, impersonal relationships at an auction in which everyone seeks to advance his own interest are different from impersonal relationships in a bureaucracy where everyone seeks to implement the rules. Third, there is an important difference between obligation-based and enjoyment-based personal relationships. For example, the close relationship of a mother who sacrifices much for the proper care of her child must be distinguished from the close relationship between two cronies having fun and possibly colluding. Ignoring these distinctions makes it difficult to even describe what goes on in market societies let alone answering the question how such societies may slip into the natural state of rent seeking.

Uzzi (1997) investigated the better dress sector of the apparel industry in New York and showed that virtually all producers in this industry had "arm's-length ties" (market relationships) and "embedded ties" (close or special relationships). The apparel industry contains simultaneously market and embedded relations, the former being a majority, the latter being the relations of special importance. Individuals (contractors, manufacturers, production managers etc) would behave blatantly with self-interest in the market and cooperatively in the embedded relationships. The embedded relations developed over a longer time and showed solidary behavior related to the specific risks and time pressures of the industry. For example, in the light of the shortage of time in which business in the apparel industry has to be conducted, a habit between embedded tie partners was "we do first and fix price after" in the firm conviction that "the contractors know that they will not lose." "If there was a problem you knew you'd work it out and they'd help you" said a manufacturer of 30 years experience. By contrast, in arm's length relationships the other would "push the price down when the contractor tells his production problems." If one kind of relationship was needed and by mistake another one was established it would create problems. As one CEO put it: "When you deal with a guy you don't have a close relationship with, it can be a big problem. Things

go wrong and there's no telling what will happen. With my guys [his key contractors], if something goes wrong, I know we'll be able to work it out." The producers needed both kinds of relationships at the same time. Comparable results have been found by many other researchers (for example Blumberg 1997, Brusco 1999, Dyer 1997, Gerlach 1992, Sitkin and Roth 1993).

What we learn from these examples is that a modern economy (one that is able to reap the fruits of the technological progress, as North et al. put it) needs flexibility in relationships, with trust and habitual other-regard at the right time with the right people, and tough negotiations at other times with the right people. The need for flexibility in relationships also arises in polycentric systems of governance where multiple governing authorities operate at different scales and this also applies to relationships between local and supra-local levels (see Ostrom 2005, Chapter 9). Polycentric governance is itself an instrument of flexibility necessary for modern economies. Flexibility in relationships also pertains to mixtures of motives within the same relationship which applies especially to governance in high performance organizations in which the intelligent effort of individuals is very important (Lindenberg, 2003). From the point of view of microeconomic theory, one can rightly ask how this flexibility is possible. For example, how is it possible to have the pricing negotiations follow rather than precede the transfer of goods without holdup problems afterwards? How is flexibility in relationships possible between levels and within organizations? As we will see in a moment, the answer comes from outside microeconomic theory and is due to advances in micro-sociology and cognitive social psychology.

Before I discuss these developments, I would like to introduce interesting findings by Evens and by Nee that point to yet another important feature of modern economies not captured by the neoclassical model. Evens and Rauch (1999) looked at economic growth and domestic investment from 1970-1990 in thirty-five developing countries from all regions of the world. They found that the strongest predictor for economic growth and a strong predictor of domestic investment was what they called "Weberianness Scale". This scale measured the degree to which bureaucracies in developing countries satisfy Weber's requirements for good state bureaucracies: Meritocratic recruitment and rewarding long-term careers. Inspired by this research, Nee and Opper (2005) have recently researched 56 countries with national stock markets (excluding transition economies) and came to a similar conclusion. Using a number of Weberian indicators (not related to economic performance), they measured the quality of the state bureaucracy and found that it alone explained 27 percent of a compound indicator of financial development (in total they were able to explain 45 percent of the variance). What is it that drives these results? Bureaucracies have often been blamed by economists for economic waste and rent seeking because they supposedly wield a monopoly over the supply of public services and thus extract a monopoly rent (see Tullock 1965, Niskanen 1994, La Porta et al. 1999, Mueller 2003). What we learn from the newer sociological studies is not that bureaucracies are innocent of waste and rent seeking, but that, under certain conditions (originally specified by Weber), they provide a huge positive net contribution to economic performance. The question is: What makes bureaucracies sometimes work in such a way as to provide this positive contribution and sometimes not? As I will elaborate in the next section, the answer to this question and the answer to the previous question about flexibility in relationships will point to the importance of certain goals and to what stabilizes or fails to stabilize these goals.

The role of goals

From microeconomic theory, we are used to take preferences as ordered and given and to look at varying constraints to explain behavior. However, consider the following experiment by Brendl, Markman and Higgins (1998). They studied students lining up at a bursar's office to pay their bill and compared them to students in the cafeteria. Presumably the students lining up at the bursar's office wanted to pay their bill. The researchers offered raffle tickets to these students for either a \$1000 cash prize or a \$1000 waiver of the student's university bill (to be decided nine days later). Those lining up to pay their bill and offered a cash prize bought significantly fewer raffle tickets than the students in the cafeteria when the prize was cash. Why was that? The answer is that a goal that is "focal" (i.e. that is activated at the moment) influences what preferences are activated and what preferences are pushed into the cognitive background at that same moment. For the students with the focal goal to pay their bill, preferences pertaining to things that were obviously instrumental for reaching their goal (such as a waiver of the bill) were activated while preferences concerning things that were of no immediate relevance (such as winning cash) were relatively inhibited. This occurred even though the lottery itself (nine days later) had no relevance for the situation at the moment. There is much evidence for this influence of focal goals on the partial activation of preferences (see Lindenberg, forthcoming).

A similar effect of goals also exists with regard to constraints. What is deemed relevant for the focal goal pursuit is keenly perceived and what is not deemed relevant is only vaguely or not at all perceived. For example, the knowledge structures that are activated by the focal goal in a given situation also affect the constraints that are being perceived. This has been demonstrated convincingly by De Dreu and Boles (1998) for an important class of knowledge structures: heuristics (or implicit theories and modes of decision making). Dreu and Boles used negotiation settings to see what heuristics pop up in people's mind when their focal goal is to cooperate or to compete, respectively. Heuristics are rules of thumb that influence expectations, the perceived interrelation of events, and the selection of means to reach a goal. They found that if the focal goal is competition, people are likely to think of heuristics such as "never trust your opponent" (this affects people's expectations of the behavior of others), "your gain is my loss" (this affects what interrelation of events people expect), or "never lay all your cards on the table" (this affects what means of negotiation people choose). If their focal goal is cooperation, people are more likely to think of heuristics such as "always give others the benefit of the doubt", "do unto others as you would have them do unto you", or "play fair". Whether it is one or the other set of heuristics makes a big difference in people's behavior. North (1990) had pointed to the importance of beliefs for the generation of expectations and that is an important point. However, as we see from the De Dreu and Boles example, even beliefs are selectively activated by goals. Goals thus influence cognitions by selectively activating affective responses, beliefs and expectations and thereby also governing the situational selection of preferences and constraints. The combination of such a focal goal with its cognitive consequences I call "goal-frame". It is evident that goal-frames could be relevant for answering the questions asked above, such as how is it possible to have the pricing negotiations follow rather than precede the transfer of goods without holdup problems afterwards? How is flexibility in relationships possible between levels and within organizations? Why would some bureaucracies be able to function in such a way that economic growth is fostered and others not? Most relevant for these questions are goals that wield whole classes of preferences and constraints and I will deal with them in the next section.

Three master goal-frames

The most general human goal is likely to be a striving for improvement of one's condition. This goal has long been recognized as a major human striving (see Ford 1987) Adam Smith already pointed to “that great purpose of human life which we call bettering our condition,”¹ a desire that “comes with us from the womb, and never leaves us till we go into the grave.”² Even though humans probably share this striving with most other species, there are three important subgoals of the improvement goal that, in combination, are likely to be found only in humans.

Hedonic goal-frame. The most elementary improvement is related to the satisfaction of the needs here and now. For humans and probably many other higher species, needs create feelings of deprivation, and thus the common goal associated with the improvement in need satisfaction is “to improve the way one feels”. This goal to improve the way one feels governs whole classes of subgoals that have to do with various needs and the various ways to satisfy them. For example, subgoals could be to find something to eat, or to seek company, but they could also relate to being accepted or admired, or to let off steam and hit somebody. What all these subgoals have in common is that they are affected by the same overarching goal and that this goal, when it is focal, will be a goal-frame governing cognitions. In this case, it will be a goal-frame with wide ramifications. Opportunities for need satisfaction will be keenly perceived; *ceteris paribus* there will be a higher alertness to effort than to money expenditure; the time horizon will be short; constraints that block need satisfaction will be very salient and create emotional responses (see Frijda 1988). In order to be able to refer to this goal with its specific cognitive processes, I call it *hedonic goal-frame*.

The gain-goal-frame. Under certain conditions, individuals can trace externalities of their own and other people's behavior on their future self so easily that it will give rise to yet another goal that governs entire classes of subgoals, viz. those connected to the improvement of one's future self (rather than to the way one feels right here and now). For example, it has been pointed out that property rights lower the cost of tracing externalities on future self so much that they will change people's concerns in favor of long-term consequences (see Lindenberg 1977). Being concerned with the improvement of the conditions for one's future self means that one is concerned about improving resources and the efficiency of the use of resources. Here again entire classes of subgoals are governed by one goal-frame. Because of the emphasis on resources, I call it *gain goal-frame*. Individuals in a gain goal-frame will be specifically sensitive to information regarding opportunities to increase their resources (Camac 1992). This includes close attention to monetary costs, or possible reduction in status. The time horizon is medium and long-term. Acting for the benefit of one's future self also involves more planning, more consideration of moves and counter moves of others (strategic behavior), more calculation and the use of knowledge than acting for the benefit of one's present self. This forward-looking, calculating, gain-oriented attitude comes close to what is assumed to be the general human attitude in standard rational choice theories. In these theories, a strong orientation to the present self is seen as creating anomalies in choice behavior (see Loewenstein and Prelec 1992).

The normative goal-frame. Under favorable conditions, people can put themselves also into the shoes of the group as a whole (or of a relationship). Research on tax morale shows that fear of punishment for not paying taxes cannot possibly explain the high degree to

¹ Theory of Moral Sentiments, I.iii.2.1.

² The Wealth of Nations, II.iii.28

which people pay taxes in many countries (see Alm, McClelland, and Schulze 1992). This might simply be an indication of stable traits and social preferences, such as internalized norms or a cooperative personality. Yet, people's tax morale is not independent of situational changes. For example, it is highly responsive to varying trust in government (see Pommerehne and Weck-Hannemann 1996, Torgler 2003) and to identifying with one's country (see Torgler and Schneider 2004). There seems to be a goal-framing effect that activates or inhibits the influence of norms on behavior. Sally (1995) performed a meta-analysis of experiments on cooperation in (dyadic and n-person) prisoners' dilemmas from 1958 to 1992 and he found that when subjects were instructed to cooperate, the rate of cooperation increased by 35%-40% (compared to experiments with no such instruction). He observed "that these instructions are slightly bewildering to an economist, because the instruction to cooperate does not change the stated payoffs of the game or the seemingly obvious domination of defection." (Sally 1995, p78). The instruction to cooperate can be taken to make the individual take a group perspective. If payoffs play a role at all, then it is the joint payoffs rather than the individual ones; it is the group perspective rather than the individual perspective. This point is strengthened by Sally's finding that in repeated games, the size of the loss to the group through defection (if all players would defect) had a strong positive effect on cooperation. Thus, the individual improvement goal can be linked to the group level, at first in terms of understanding group goals, and then, if and when the identification with the group is stronger, in terms identifying with group goals. This phenomenon is by now empirically well established (see Caporael, Dawes, Orbell, & Van de Kragt, 1989; Hogg 2001; Kollock, 1997). Concerning the behavior and attitudes of the individual member, groups develop standards or norms and rules about what is *appropriate* towards the group as a whole, towards other groups and in various kinds of relationships (such as friendship, business, authority relationships). These standards, norms and rules may have clear functional aspects. For example, they may pertain to a collective good (each individual needs to contribute) or to the regulation of negative externalities (such as non-smoking norms). They may also indicate ways to achieve joint production (such as operating procedures in organizations) or belong to the ritualistic culture that reinforces the identity of the group. For example, it may be a sign of belonging to a nation that one behaves in a certain way (say, hand on heart) when the national anthem is played. Taking the perspective of the group (or relationship) then corresponds to having the focal goal "to act appropriately". Such a goal also constitutes a goal-frame that yields large classes of subgoals. I call it the *normative goal-frame*. The time horizon of this goal-frame is mixed. In terms of action, it is short term because people in a normative goal-frame are motivated to act appropriately in the given situations they are in. However, because norms pertain to the dyad or group, they are themselves often directed towards the longer term, including the maintenance of the dyad or group. For example, the norm to answer letters promptly is instrumental for maintaining the relationship with the writer of the letter in the longer term. Legitimacy plays an important role here (see Lindenberg 1992). A normative goal-frame cannot be simply imposed on people. Rules that are established through power advantage and experienced as such (such as is likely to be the case with a prohibition of chewing gum in a school) may create fear of sanctions and conformity and but do not guide behavior in a normative goal-frame (Smetana 1993). This difference between a hedonic or gain goal on the one hand and an appropriateness goal on the other is almost a hallmark for finding out whether young children have or have not yet developed moral motivation (see Nunner-Winkler 1997). In other words, if norms are followed because one is in the mood to do so or because one wants avoid the sanctions that follow nonconformance, then one's behavior becomes very sensitive to opportunities that have nothing to do with appropriateness but with the way one feels or with

the intensity of monitoring. Sanctions in a normative goal-frame are very important, but they serve the protection of fairness (Fehr and Rockenbach 2003) or the symbolic value of the norm (Steglich 2003) rather than the discouragement of deviance through disincentives.

The relative strengths of the master goal-frames

As discussed above, the gain-goal-frame depends on situations that make it easy for a person to trace externalities of own and others' behavior on one's future self. The normative goal-frame depends on conditions that make it easy to identify with the group. The hedonic goal-frame, being related to need satisfaction and thus the most basic, is very likely to be apriorily the strongest of the three master goal-frames. In other words, it probably needs the least support from the social surrounding of the individual. The normative goal-frame, relating to the group and not to the individual (present or future) self, is likely to need the strongest support from the outside in order to become a focal goal. Thus, these goal-frames are dependent on flanking social and institutional arrangements. Far from being the default goal-frame, as microeconomic theory would imply, the gain goal-frame also needs much social and institutional support. Support for the gain goal-frame and the normative goal-frame may come to work at cross-purposes. This offers us possibilities to theorize about the sustainability conditions of what North et al. called "open access" societies.

The role of goal-frames in open access societies

The importance of relational contracting.

The more advanced the technology, the more likely that jobs that can be taken over by machines will have been taken over by machines. This is true for production as well as service industries. This leaves more jobs for which intelligent effort is essential. Thus, societies that would gain most from open access in order to realize the potential of technological developments are societies in which the majority of jobs requires intelligent effort. Intelligent effort is difficult and often impossible to put into contracts, and monitoring intelligent effort is very limited. Trust thus becomes an integral requirement for many kinds of employment relationships and the training and motivation of the employee become more important than before. As a result, replacement costs shoot up and companies will put more effort into governing the relationship with the employee. For example, Mühlau and Lindenberg (2003) investigated the workings of efficiency wages in Japanese and US organizations. They found that what creates commitment to organizational goals and to the willingness to exert intelligent effort is not the threat of being dismissed but the signal by the employer that he is interested in the relationship with his employees. This means, among other things, that organizational commitment of an employee depended more on how the employer treats others in the firm (a signal of his general interest in the relationship with his employees) than how he treats oneself as employee and this is a major difference with the assumption that commitment is a matter of personal wage incentives.

A similar point can be made about contracting in general. The more complex the technology, the more likely that contracts will be incomplete and that they will become relational (Macneil 1978). The specific reasons why parties may turn to relational contracts differ somewhat. For example, Macneil refers to the increased complexity and length of contracts with many unforeseen *ex post* contingencies which make people turn to informal agreements governed by norms and solidarity. Williamson (1985) points to the "fundamental

transformation" of impersonal market transactions into relationships between identifiable partners when the partners have to make investments that are specific to the relationship (and this also happens in employment relations) and when monitoring is difficult. Ever since Macaulay observed this in 1963, there have been numerous empirical studies on this topic. For example, Beale and Dougdale (1975), Esser (1996), Kenworthy, Macaulay and Rogers (1996), and Scott (1987) all found empirical evidence in the field for relational forms of contracting, and others (for example Fehr et al, 1998, Brandts and Charness 2004; and Brown et al, 2004) found supporting experimental evidence. Kollock (1994) shows experimentally that uncertainty greatly increases the likelihood of relational contracts.

In their influential textbook on organizations and contracts, Milgrom and Roberts (1992, p.131) discuss relational contracts where each agrees to give his best efforts to developing the joint project, to share the costs and benefits, to consult with one another as new developments occur, and to bargain in good faith when disputes arise. They say that such contracts can in fact work quite effectively, "when...the parties are not inclined to be too opportunistic in their dealings with one another." But the crucial question is: What makes them inclined not to be "too opportunistic"? Similarly, Miller (1992) argues that what is needed is a constitutional solution with a "permanent restriction" of parties' ability to pursue self-interested behavior at the expense of long-term cooperation. How would it be possible to bar parties from behaving this way? Simply ruling out this kind of behavior in some constitutional agreement will not do, just as interest alignment itself will not suffice.

When one considers goal-framing, it become quite obvious why these solutions alone cannot keep contracting partners committed to rules, contractual agreements and organizational goals. In various publications, I have argued this point in some detail (see Lindenberg 1988, 2000, and Chasserant 2003 for an overview). The basic idea is that long-term interest is often not clear, and even where it is reasonably clear, it will be periodically displaced by short-term interests (due to the higher apriori strength of the hedonic goal-frame). Interest alignment helps reduce strategic opportunism and that is very important. However, even it reduces strategic opportunism, it does not get rid of it, and it does not affect *myopic opportunism* by which people will give in to short-term temptations to break agreements, bend rules to their own advantage, twist the truth, etc, in favor of "golden opportunities", or when they are confronted with time pressure or with loss or threatened loss. Partners will react to perceived infringements with infringements of their own. This creates cascades of negative reactions that deteriorate the relationship. For example, people often react quite emotionally to loss or threatened loss, which shifts them into a hedonic goal-frame with a short time horizon. In Uzzi's (1997) investigation of interfirm networks in the apparel industry mentioned above, it turned out that if trust (in embedded relations) is broken, vendettas and endless feuds can arise. This can be very destructive of both partners' resources. Uzzi reports a CEO as saying "If you screw a guy like that [i.e. a close tie] he'll stay in business just long enough to get even." (p.59). Kaufmann and Stern (1988) have also shown that if one partner believes that the other acted opportunistically, the relationship is likely to change completely and become nasty.

In addition to loss effects, there is evidence that norms are often ambiguous and that people will exploit this to their own advantage. For example, Babcock and Loewenstein (1997, p. 120) observed, that the moment a slight asymmetry is introduced between the parties (such as different nonagreement values or costs of non-settlement) then the parties' notion of fairness will tend to gravitate toward a division that favors themselves. Often, this can be quite harmless, but at other times, it may be quite costly and block cooperation by (maybe falsely) signaling opportunism and disregard for the relationship with deteriorating cascades as a result.

What sustains a normative goal-frame in relational contracting?

When it comes to keeping to ground rules and to guarding the relationship itself, both contracting partners must be acting from a normative goal-frame with gain and hedonic goals being pushed into the background, and this also holds for employer and employee. When is the normative frame likely to be sustainable? My short answer is: It is sustainable only by a multitude of arrangements, both in the institutional and in the personal sphere. What are they? The following arrangements have been found to be important (and probably there are others as well):

- First, with, interest alignment will reduce the likelihood that people are tempted into a gain or hedonic goal-frame for situations in which they should be in a normative goal-frame. For example, when interests are aligned, the potential conflicts between following the rules and increasing one's income or advancing one's career opportunities will be reduced. In organizations, everything that reduces interest alignment (such as promotion schemes that are meant to align interests but, due to proxy measures of intelligent effort, factually decrease alignment by the agent's sole focus on those aspects that supposedly measure his intelligent effort) will reduce the strength of the normative goal-frame.
- Second, when interests are not well aligned, the relative weights of the hedonic and the gain goals (that are pushed into the background) should be relatively low for those circumstances in which a normative goal-frame is called for, lest they become stronger than the normative goal-frame whenever there is a slight temptation to do so. Thus, whatever increases the relative weight of the gain and/or hedonic goals will threaten the stability of the normative frame. For example, increased market competition (though it is seen in the economic text books as always healthy) will decrease the stability of the normative goal-frame by increasing the relative weight of the gain frame. Increased status competition will put a heavier weight on conspicuous consumption and thus on a hedonic goal-frame, also threatening the stability of the normative goal-frame.
- Third, when various aspects of the relationship are (also) subject to formal contracting enforced by law, the range of informal, i.e. relational, contracting can be better calibrated to situations in which it can thrive (see Klein 1996). This supporting role of the courts is well illustrated by the study by Johnson and McMillan (2002) about relational contracting in eastern countries such as Russia. When courts are corrupt or don't work properly, relational contracts will become both more numerous and less stable, giving rise to private justice and corruption. The functioning of courts must rely on the other conditions mentioned here.
- Fourth, knowing what the appropriate behavior is (for example by good professional training) will reduce the situations in which individuals will switch to a gain or hedonic frame because they cannot find the normative alternative (see Babcock and Loewenstein 1997). Inside organizations, this knowledge includes the degree to which an employee understands the working of the entire organization (see Lindenberg 1993). Thus, everything that reduces this knowledge (either by lack of training or by vague standards and norms) will weaken the stability of the normative goal-frame.
- Fifth, goal-frames are highly interdependent (see Aarts, Gollwitzer and Hassin 2004) and the most influence is exerted by the examples of highest status. This means that behavior of political and corporate leaders and the highest government officials will have a strong influence on the stability of a normative goal-frame. Any sign of opportunistic behavior of these highly placed people that is made public and condoned among these highly

placed people will weaken the strength of the normative goal-frame of others below them in rank and status. For example, Torgler (2003) has shown that trust in government officials (also those not related to the chance of being caught) significantly influences tax morale. Hammar et al.(2005, p.18) report that in the Swedish Tax Agency (STA) recently found the second most prominent reason for tax evasion to be "that individuals in prominent positions are breaking social norms."

- Sixth, because goal-frames are so interdependent, people have an interest to signal their normative goal-frame to others and are keen on observing whether others signal the same in situations that are critical to commitment to ground rules and relationships (for an empirical study of this "relational signaling" see Mühlau and Lindenberg 2003). Frey (1997) and Feld and Frey (2002) have shown this to be the case for tax morale. Thus negative relational signals (such as disrespectful treatment of citizens by the government, or examples widespread non-compliance, see Torgler and Schneider 2004) or everything that interferes with the functioning of relational signals (such ill-defined notions of what is appropriate behavior or ill-defined relational expectations, see Wittek 1999) will increase the likelihood that a person's normative goal-frame will give way to a gain or hedonic goal-frame (see also Meyer, Becker and Vandenberghe 2004).
- Seventh, stability of the normative goal-frame is greatly aided by people being embedded in networks of similar ties in which the norms are reinforced, in part by reputational effects (see Buskens 1999, Jones, Hesterly and Borgatti 1997). Thus, everything that reduces network embedding (such as fragmentation, strong competition or high turnover) will also reduce the stability of the normative goal-frame.

What keeps bureaucrats committed to rules?

Open access to political and economic markets means that individuals are not barred from participating in markets because they do not have personal ties to those already in the markets or to regulators. Thus, it seems logical to contrast societies by the nature of relationships: Are they impersonal (i.e. open access) or personal (i.e. natural state), as North et al. (2005) have suggested. A similar point was made by Greif (1998) in his analysis of the Maghribis traders in the Mediterranean in the eleventh century as compared to the Genoese merchants toward the end of the eleventh century. The Maghribis traders were organized on the basis of a collectivist enforcement mechanism (with a horizontal social structure and collective punishment) whereas the Genoese merchants were organized on the basis of individualistic enforcement institutions that support *anonymous* exchanges. Thus, "the medieval Latin individualist society may have cultivated the seeds of the 'Rise of the West.'" (Greif 1998, p.97). Seabright (2004) argues at length that it is markets and firms that make anonymous exchanges possible. However, as I argued above, markets and firms need, next to anonymous exchanges, also relational contracts. In addition, they need a well functioning bureaucracy and all that it takes to sustain such bureaucracies. I will argue that the functioning of these bureaucracies requires, just like relational contracting, stable normative goal-frames. This, in turn, may clash with efforts to stabilize the gain goal-frame. Max Weber's work has extensively dealt with the importance of bureaucracies for market societies and with the role of normative goal-frames for the functioning of bureaucracies. I will briefly recapitulate his main points in this regard.

Weber (1961, 1978) has described at length how the gain goal-frame came to be institutionally supported against the hedonic goal-frame in a long course of historical

developments of law (especially Roman law), religion (especially innerworldly asceticism), and technology (especially regarding administration and war) in Europe, leading to the rise of capitalism and thus open access societies. For the sustainability of such societies, Weber put the conditions that sustain the tractability of externalities on future self at the center of importance. He argued that, given that the government condones profit making, the space of autonomy needed for a capitalist economy rests on the *ability of an enterprise to calculate*. For him this ability to calculate is the single most important feature of a capitalist economy and it only comes about when a number of conditions are fulfilled (see Weber 1978, p.161f):

- (1) property rights: complete appropriation of all material means of production by owners and the complete absence of all formal appropriation of opportunities for profit in the market;
- (2) complete autonomy in the selection of management by owners;
- (3) free labor, freedom of the labor market, and freedom in the selection of workers;
- (4) freedom of contract;
- (5) a mechanically rational technology;
- (6a) complete calculability of the functioning of public administration and the legal order and
- (6b) a reliable purely formal guarantee of all contracts by the political authority; (7) the most complete separation possible of the enterprise and its conditions of success and failure from the household or private budgetary unit and its property interests (especially separation of capital at the disposal of the enterprise from the private wealth of the owners);
- (8) a monetary system with the highest possible degree of formal rationality.

Today, some of these conditions would be formulated in a slightly different way. Still, Weber has come up with a list of important sustainability conditions for the ability of an enterprise to calculate. Under these conditions, each individual economic actor is oriented towards income and "all business profits of enterprises will...be turned into the income of economically acting individuals." (Weber 1978, p.204).

One point is especially relevant for our context. The calculability of the functioning of public administration and the legal order (condition 6a) depends, so argued Weber, on a certain kind of organized legitimate authority: the rational legal type of authority. But he also maintains that this type of authority relationship is the most important type of employment relationship in a capitalistic economy, be that in the state bureaucracy, political parties, in banks, or in large enterprises (Weber 1947, p.272; 1978, p.223). What is this relationship? According to him, it is based not on personal ties but on a commitment to *positional* obligations. These obligations, in turn, are linked to functional (and thus rational) rules and norms which render the authority relation functionally legitimate (i.e. based on expertise). For this reason, recruitment must be based on proven competence. This line of argumentation has also been adopted by Evens and Rauch (1999) and Nee and Opper (2005) mentioned above, and their data support it. It relies on the assumption that professionals are committed to follow norms of professionalism. A modern author who studied the importance and preconditions of anonymous exchanges, Paul Seabright (2004), argued that "almost all occupations in a modern society embody an ethic, a code. For trust requires an assurance of reliability and some of the most effective policemen are internal, lodged in the surveillance mechanism of the individual personality. The fiercest external vigilance will rarely be enough to ensure the honesty of a really determined cheat." This is very insightful, and comes close to the idea of a normative goal-frame. However, neither Weber, not Evens and Nee, nor even Seabright seriously consider the precariousness of the normative goal-frame vis-a-vis the gain and especially the hedonic goal-frame. They see various sources of stability of the normative goal-frame, none of which they see as problematic: honest types (character), honest

upbringing (socialized with internalized norms and values), and interest alignment. Seabright sees the stability coming from honest types and from upbringing, i.e. from "people whose character, training, or upbringing leads them not to want to cheat even when they have the chance." (Seabright 2004, p.90). This would boil down to a particular selection of personality types or people with internalized norms and values who will not be tempted into deviance. But in terms of goal-framing this would also imply that once we have recruited such people, the normative frame does not need any support to withstand the onslaught of gain and hedonic goal-frames. And this is contrary to the facts.

Principal-agent theory (Sappington 1991) assumes that people are always in a gain goal-frame and that it is mainly a matter of aligning the individual and organizational interests in order to make people stick to rules, even if one assumes bounded rationality. Weber (1978, p. 220) may indeed have thought in the same direction when he pointed to certain incentives that can be taken as alignment instruments, such as fixed salaries with rights to pensions and career employment with promotions dependent on superiors. However, elsewhere, Weber assumed that through secularization of Protestantism, the life of the bourgeoisie in a capitalistic society is still ethically regulated in terms of self-discipline and a sense of obligation (Weber, 1947, 84ff). In fact, Weber did not believe that interest alignment alone would keep people committed to following rules. "There is a tempering of the unrestricted quest for gain...The result is a regulated economic life with the economic impulse functioning within bounds." (Weber 1961, p. 262). But then, there is alas no close attention by Weber on how the "unrestricted quest for gain" is actually tempered, how the "systematic conduct of life" developed by Calvinism can be preserved in a secularized world in which the individual pursuit of gain is both socially and institutionally highly supported. Elaborating on Weber, Evens and Rauch (1999, 752) argue that, in well functioning bureaucracies, it is the meritocratic recruitment that fosters identification with the organization and, as a consequence, with professional norms and goals belonging to the office. But ultimately, they seem to rely solely on instruments of interest alignment. For them, it is the long-term career perspective that reduces short-term temptations to deviate from professionalism. From all we know about relational contracting (see above), the pure threat of dismissal or blocked career opportunities will not be sufficient to create commitment to rules and norms, nor will recruiting "honest types" and well-brought up individuals do away with the dangers of myopic opportunism. As Milgrom and Roberts (1988) observed, bureaucrats, tempted by promotion schemes that are meant to align their interest with that of the organization, are, just like their colleagues in firms, in danger of solely focusing on activities that get them promoted, even if this means neglecting what needs to be done in terms of their tasks. What is more, bureaucracies will almost certainly become targets of rent seeking activities from players outside the bureaucracies, putting a strong pressure on the normative goal-frame of bureaucrats in favor of gain or hedonic goal-frames. Rent seeking and corruption can certainly be found in bureaucracies all over the world, not just in developing countries (see for example Birnbaum 1992, Mauro 1995, Shleifer and Vishny 1993, West and Loomis 1999). What, then, will strengthen their normative goal-frame against the onslaught of the gain or hedonic goal-frame?

As already mentioned, Weber (1978, pp.220ff) had suggested selection at the port in terms of professionalism, a fixed salary and internal career possibilities to keep bureaucrats tied to their positional obligations. These things are important but, as we have just mentioned, their ability to do the job is limited. Career opportunities can increase strategic behavior with high influence costs (i.e. internal rent seeking) and the expertness that comes with the professional training can help legitimize opinions as being objective even when they have been bought by third parties from the outside (see for example Schulman 2002). What is

needed to stabilize the normative goal-frame in bureaucracies, it seems, is again, the array of stabilizing conditions, as discussed above for relational contracting. The difference is that certain measures in this array are likely to be more important than others. Of special importance is to keep the relative weight of gain and hedonic goals low and the knowledge regarding appropriate behavior high (see McHoskey 1999). Interest alignment through financial incentives is difficult to achieve in bureaucracies because performance is even more difficult to measure than in many firms and thus, financial incentives would have to be pegged to very rough proxy measures, thereby reinforcing strategic behavior (in a gain goal-frame) and creating potentially high influence costs (see Milgrom and Roberts 1988). This argues strongly against the introduction of a market orientation with "production", competition, and bonuses in bureaucracies (which is different from instilling a client-orientation). Rather, it speaks for seniority promotion and organization of tasks in terms of projects in order to reinforce the normative goal-frame and the obligation-based intrinsic motivation that goes along with it (see Echteit, Glebbeek, and Lindenberg 2006). This kind of organization also depends on relational signals and identification with the organization. In order to keep the knowledge requirements high, it is important to stick to high standards of professional training (as Weber already observed) and easy access to relevant information, including information on functioning of the entire bureaucratic decision making process through job rotation and social networks (see Lindenberg 1993, Meier and O'Toole 2003, Provan and Milward 2001).

Endogenous instabilities in open access societies

What we have shown so far is that open access societies need impersonal exchanges, but that impersonal exchanges need to be flanked by personal ties (for establishing trust with incomplete contracts) and by strong supports for normative goal-frames (for the well functioning of state bureaucracies). These supports, in turn, also require some measure of personal ties in the form of relational signals, identification with the organization, and social networks. This dependence of impersonal exchanges on personal ties creates a possible source of endogenous instability. A complex market society will inevitably flank the impersonal ties with personal one, and the question is what keeps the personal ties from crowding out the impersonal ones where it matter most (say in guarding open access to political and economic markets)?

Stabilization of the gain goal-frame at odds with the normative goal-frame

The danger of personal ties crowding out impersonal ones comes from two sides. One side is very obvious and points to yet underdeveloped parts of the market: the imperfections of political and economic markets and the flanking institutions. When courts don't function, when quality is difficult to gauge, when property rights are uncertain etc. personal relationships will be the most common form of tie in economic transactions (see Johnson and McMillan 2002).

Ironically, in developed market societies the danger comes from the other side as well: The *underestimation* or downright neglect of the importance of personal ties for open access. As market societies grow, there is a dual battle on virtually all levels of society, be they social, cultural, or political. First, there is a battle for the stabilization of the gain goal-frame against the hedonic goal-frame. This battle is ideological in that it extols the self-

responsibility of human beings (without which there would be too little consideration of one's future self) and, connected with that, a battle against the legitimacy of sloth.

Second, there is a battle against beliefs that cling to the older natural state society, often for reasons of privilege. Here, economists play a special role. Adam Smith had already pointed to the tendency of entrepreneurs to want to establish monopolies; Olson has analyzed the tendency of market societies to develop special interest groups to influence the political process; and Tullock has pointed at the danger of rent seeking even in market societies. The endogenous tendencies in market societies against open access basically come from market players themselves and from people who are either ignorant or defensive of some kind of privilege. Economists are the major source and guardian of a belief system that extols the advantages of markets against monopolizing tendencies and against beliefs that are critical or fearful of markets (see Lindenberg 1986). This includes a heavy emphasis on the importance of impersonal exchanges and the dangers of personal relationships (rent seeking, collusion, corruption). Since impersonal exchanges allow only impersonal incentives, economic theory focuses mainly on these incentives (both positive and negative). The form of governance that fits with impersonal exchanges in combination with impersonal incentives is one of financial enticement and financial or repressive deterrence.

This emphasis on impersonal incentives leaves little room for considering the necessary flanking of impersonal exchanges by personal ties and organizations based on normative goal-frames (bureaucracies). In fact, the ideological importance of the text book theory of markets that people are mainly driven by impersonal incentives is so strong that the whole idea of goal-frames has not had much of a chance to penetrate into economic theory even though there is massive experimental evidence in its favor³.

A consequence of this focus on impersonal exchanges and the vast belief system surrounding it is that the criteria for judging the performance of governments have also been developed by economists and have gained increasing acceptance, especially after the Cold War. They boil down to judging the degree to which governments push impersonal exchanges in every walk of life (lest they condone rent seeking, collusion, corruption, and sloth). As we have seen above, such an emphasis stands in the way of a serious analysis of the degree to which impersonal exchanges are made possible by relational contracting and bureaucracies. Inside organizations (and especially in bureaucracies), this emphasis on impersonal exchanges is likely to crowd out the normative goal-frame and with it positive relational signals. This is especially damaging where interest alignment is shaky, or, if interests are well aligned, where room for myopic opportunism is large (see also Frey and Osterloh 2005). The irony is thus, that the massive support of impersonal exchanges and impersonal incentives in advanced market societies leaves little room for considering those props of impersonal exchanges that cannot be governed by impersonal incentives.

The hedonic goal-frame at odds with gain and normative goal-frame

There is one more likely source for the endogenous instability of open access societies. Whereas financial and production markets need gain goal-frames, consumer markets need hedonic goal-frames to function properly. The more impatient people are to buy whatever they desire at the moment, the better. This means that in market societies, there is a strong emphasis on spending money, buying things. As the German chancellor Ludwig

³ Recently, some incentives have been considered by economists that are social and not impersonal, however they are treated stable traits ("social preferences", see Fehr and Fischbacher 2002, Charness and Rabin 2002) which again neglects goal-framing and leaves the traditional theory still incapable of dealing with *precariousness* of both gain and normative goal-frames and the social supports they require.

Erhard said to his people that was still reluctant to spend its money after World War II: "Dare to embrace living well and spending money". Again, the hedonic frame cannot be arbitrarily stopped, even when it goes so far as to make people spend more than they earn, create "luxury fever" (Frank 2000) and foster obesity (see Offer 2006). It is very likely that the strong emphasis on a hedonic goal-frame for consumers spills over into situations in which gain a goal-frame or a normative goal-frame would be more adequate. A hedonic frame will make people more impatient for immediate results, will make them more prone to see what they want to see ("motivated cognition") and will make them more sensitive to the situational aspects of encounters, all of which favor leaning on personal relations beyond what is needed to service relational contracting. For example, when the *Challenger* Space Shuttle exploded, a commission looked into it with the idea that there must have been some sinister managers who calculated the costs and benefits and were willing to take the risks at the expense of others. This is also what was found by the commission. Yet, a careful reanalysis of the case turned up a different story (see Vaughan 2001). The organizational structures at NASA that gave room to cumulative effects of motivated cognition in combination with reliance on and cover by personal relations were seemingly much more to blame than amorally calculating managers. Seemingly, the wish to stretch the edges of rules is accompanied by too favorable estimates about the leeway and the consequences of stretching them, and personal relationships will reinforce this process (see Vaughan 1999). In corporate fraud cases, accountants are lulled into seeing little wrong in "creative bookkeeping" and personal relationships will muffle the "voice" option of those who are supposed to blow the whistle. An approach based on strong deterrence against malfeasance will have a chance against monopolists but not against this creeping growth of the misplaced hedonic goal-frame. In short, the heavy emphasis on a hedonic goal-frame for consumers is an additional source of tension between all three master goal-frames in market societies (see also Coleman 1982). Economist trying to save impersonal exchanges by heightened emphasis on impersonal incentives (positive and negative) will unwittingly contribute to rather than stop the endogenous instability of open access societies. This will not change until the hegemony of the belief system that sees impersonal exchanges only dependent on impersonal incentives will admit scientific evidence that has so far been seen as alien. At the moment, there is almost no open access to this closed belief system.

Conclusion

"Natural state" societies are societies in which access to economic and political markets are governed by personal relationships (with rent seeking), and modern market societies are characterized by open access to these markets. "How is it possible for open access states to slide back in to Natural states?" This question by North et al.(2005) motivated this paper. The conclusion I came to is that there are endogenous instabilities in open access societies that cannot be solved by an even stronger emphasis on markets. In fact, I argue that economist trying to save impersonal exchanges by heightened emphasis on impersonal incentives (positive and negative) will unwittingly contribute to rather than stop the endogenous instability of open access societies. I offered three reasons for this in this paper. First, impersonal exchanges need to be flanked by relational contracts (embedded in networks). These contracts and their embedding do not function with impersonal incentives. Unless we understand how they work, we cannot study the ways in which they can be kept from

deteriorating into rent seeking arrangements. Yet, the economic theory offers little for the understanding of relational contracts and their embedding. Second, impersonal exchanges need to be flanked by well functioning bureaucracies. These bureaucracies, in turn, need to be run by people who are strongly committed to keeping to the rules. An emphasis on markets and impersonal incentives for all walks of economic and administrative life drives out this rule-oriented commitment, thus contributing to an endogenous instability of open access societies. Again, economic theory can offer little to understand how this works. Third, consumer markets stress immediate gratification thereby legitimating impatience and emphasizing the need to get instant rewards from personal relationships, including conspicuous consumption. This trend, in turn, works against keeping relational contracting from growing into rent seeking, collusion and corruption. It is, in fact, another endogenous instability of open access societies. Economic theory misses the instruments to capture this effect. What is needed is a widening of economic theory with effects of goal-framing, that is, the power of goals to activate only certain preferences and to represent only certain constraints in a given situation. There is plenty of empirical evidence for these processes. I may conclude by saying that an open access society also needs an economic theory that is open to what we know about endogenous instabilities of market societies and their causes.

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