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Hard Law

Katarina Zajc
Laws School, University of Ljubljana, Ljubljana, Slovenia

Abstract

Hard law represents rules that are binding and precise and delegate the power either to explain or adjudicate to third parties. Soft law, on the other hand, does not have a status of a binding rule but nonetheless influences the behavior of public. The literature still debates whether the hard and soft law are either complementary or antagonistic. Especially with development of EU, we can see that soft law has gained momentum. We will see more soft law in the areas of uncertainty or in areas where the changes are day-to-day occurrence or where soft law usually paves the way for the hard law.

Definition

> Hard law refers to legally binding obligations that are precise (or can be made precise through adjudication or the issuance of detailed regulations) and that delegate authority for interpreting and implementing the law. (Abbot and Snidal 2000)
>
> Soft law, on the other hand: ". . . consists of rules issued by lawmaking bodies that do not comply with procedural formalities necessary to give the rules legal status yet nonetheless influence the behavior of other lawmaking bodies and of the public." (Gersen and Posner 2008)

The desire to gain and distribute rights among people and the disputes about rights are as old as human race. Therefore, usually governments/states take on the role of enacting the rules in order to distribute the rights and solving disputes. Even though Coase (1960) claimed that rules are not necessary if the rights are distributed and transaction costs are zero. However, we do not live in the world of zero transaction costs, and rules might be therefore beneficial.

Broadly speaking, the governments/states have either hard law or soft law at their disposal, depending on the goal that they try to reach with enactment of the rules and the advantages and disadvantages associated with each.

Even though definitions of hard law vary to a certain degree, the literature agrees that hard law represents rules that are binding and precise and delegate the power either to explain or adjudicate to third parties (Abbot et al. 2000). Hard law rules therefore have to be precise in such a way that it is unambiguous what kind of conduct they prescribe or require even though some hard law rules are and can be somehow relaxed along its dimension. If they are too relaxed, they might fall under the realm of soft law, even though they are binding and delegate the power to adjudicate to some third party. Hard law puts obligations on the entities within the realm of the jurisdiction of the hard law,

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and if the entities breach their obligations, the sanctions are prescribed ex ante. For example, almost all legal regimes include a maxim "neminem laedere," the obligation of not hurting anybody. If somebody commits a tort and is found liable in the court of law, it usually has to pay damages, which range is prescribed in law ex ante. Committing a crime usually means times in prison, which is also predetermined in hard law ex ante. Delegation means that special institutions, for example, courts, arbitrations, and similar bodies, have the authority to interpret the legal rules to a certain degree and to adjudicate the dispute.

Hard law is enacted in the parliamentary bodies of countries, and very rigorous rules are used in order to pass the hard law in the parliament. Usually, the rudimentary rules about the enactment of hard law are legislated in the Constitution and further elaborated in certain legislative acts. For example, in a parliamentary system with bicameralism, only the government, each parliament member, a higher parliamentary chamber as a whole, or a certain number of voters can propose an act. (Article I, section 7 of the US Constitution requires that a bill be approved by both houses of Congress and signed by the President.) The proposal of an act has to have certain elements, for example, the reasons for enactment of the act, goals of the enactment, financial consequences for the country's budget, confirmation that there are enough assets in the budget to support the act once, and if, enacted, comparative study. There are usually certain prescribed phases through which the act should go before the final vote is taken in one of the chambers of the parliament. Once the lower chamber passes the law (using different majorities as prescribed either by the Constitution or other acts), the higher chamber has to pass it too. They can veto the act and then the lower chamber has to pass the law with higher majority than the first time, for example, with absolute instead of the relative majority. The president usually executes the act and the act is published in the official gazette.

Advantages and Disadvantages of Using Hard Law as Opposed to the Soft Law

One of the main advantages of hard law is that it reduces the transaction costs of subsequent transactions, since the rules, once enacted, regulate all future behavior regulated by the act. (see Abbot and Snidal 2000.) For example, if the parties are in a contracting relationship, they do not have to either negotiate over the provisions (even though not all provisions are defaults in a sense that the parties can contract around, one of the provisions are mandatory, meaning that the parties cannot change them with the contract) or do not negotiate at all about the provision enacted in the Law on Obligation. The transaction costs of contracting are therefore decreased. Also, hard law, in domestic law and in international relations, strengthens the credibility of commitments and decreases the costs associated with the problems of incomplete contracts. Parties of the contract, for example, know that if one of the parties breaches the contract or obligation, they could file a claim at predetermined institutions which must adjudicate according to rules and impose sanctions determined by law and can therefore rely on the promises made by the parties in the contract. In other words, adjudication is guaranteed and costs of it are fixed and determined ex ante. Credible commitments are crucial in situations when one party performs its obligations before the other party, when there are asset-specific investments made upfront, basically in any situation in which one party is vulnerable to the other. Without such credible commitments, the number of transactions would drop or transactions would be made among parties that know and trust each other, which diminished the number of potential partners and consequently the advantages of contracting.

Disadvantages of Hard Law

A major disadvantage of hard law is the cost of its enactment. As already described, the procedures

are rigorous, and the agreement among the parties deciding about enactment of the hard law must be pretty high. Also, once the act is passed and in the case that is very precise, it cannot adjust to the changed circumstances which might not be advantageous in certain circumstances, for example, in the area of finance where changes are occurring daily. However, it should also be pointed out that even some procedures to enact soft law can be very costly.

Interaction of Hard and Soft Law

The literature still debates whether the hard and soft law are either complementary or antagonistic (see Shaffer and Pollack 2010.) Complementarity is seen in two ways. Soft law can lead to adoption of hard law with the same content, and hard law can be further elaborated and explained through soft law provisions. However, especially in the international relationships, the hard and soft law can be antagonistic, especially in the situations of significant distributive conflicts and pluralistic regime complexes. The antagonistic interaction of hard and soft law can in the mentioned situations lead to "hardening" of the soft law and "softening" of the hard law.

Conclusion

Hard law might be advantageous to reach some goals of the government. However, especially with the development of the EU (Trubeck et al. 2006), we can see that soft law gained momentum. As literature claims, we will see more soft law when the formalities of the hard law rise relative to the costs of the soft law. It could be also said that we will see more soft law in the areas of uncertainty or in areas where the changes are day-to-day occurrence as, for example, on the financial markets where rules should be very flexible. Also, as we see predominantly in the EU law, soft law usually paves the way or tests the waters for the hard law.

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Hardship

▶ Impracticability

Harmonization of Tort Law in Europe

Mauro Bussani[1,2] and Marta Infantino[1]
[1]University of Trieste, Trieste, Italy
[2]University of Macau, S.A.R. of the P.R.C., Macau, China

Abstract

The aim of the entry is to provide an overview of the projects regarding harmonization of European tort laws and the costs and benefits associated with them. To this purpose, the entry critically examines the arguments for and against tort law harmonization in Europe and investigates the assumptions and approaches underlying the many institutional and academic initiatives in the field. The entry tentatively draws some conclusions about the short- and long-term prospects of European tort law harmonization.

Definition

Processes aiming to align European tort law rules and practices, either through hard or soft law measures.

Introduction

In the past decades, the idea of harmonizing European private laws has been high on many agendas – especially in the EU institutions and among European legal scholars. While at the beginning institutional and doctrinal efforts mostly focused on contract law, tort law has recently been added to the picture, and its harmonization at the European level has now become a primary goal for many EU institutions and research groups.

The aim of this entry is to offer an overview of the various projects regarding harmonization of European tort laws and the costs and benefits associated with them. To this purpose, the entry will start with a description of what European tort laws have and do not have in common (section "The Variety of European Tort Laws"). Against this framework, we will be able to appreciate the arguments that have been put forward for and against tort law harmonization in Europe (section "Harmonization's Pros and Cons"), as well as the assumptions and approaches underlying the many institutional and academic initiatives in the field (section "The EU's Piecemeal Approach" and "Scholarly Endeavors"). We will first deal with the steps taken by the EU institutions in harmonizing substantive and conflicts of law rules in tort law matters (section "The EU's Piecemeal Approach"). We will then investigate the main features of the research groups that have recently been established to support – although through different means – the Europeanization path (section "Scholarly Endeavors"). Some of these initiatives, like the *European Group on Tort Law* and the *Study Group on a European Civil Code*, seek to draft a "soft" European tort law, e.g., a law the binding force of which is not derived from the official authority conferred by its source but from the high reputation enjoyed or displayed by its compilers (section "Striving for Harmonization: The European Group on Tort Law and the Study Group on a European Civil Code"). Other projects refuse to devise solutions and engage instead in deepening the dialogue between European legal cultures. This is particularly the case with two projects – the *Ius Commune Casebook for a Common Law of Europe* and the *Common Core of European Private Law.* Despite some divergence, both are devoted to developing a better knowledge of European legal landscapes (section "Building Knowledge: The Ius Commune Casebooks for the Common Law of Europe and the Common Core of European Private Law Project"). Such an overview will allow us to draw some conclusions about the short- and long-term prospects of European tort law harmonization (section "Conclusions").

The Variety of European Tort Laws

European tort laws are far from being harmonized. Judicial opinions in tort disputes (as in any private law conflict) range from being concise and, in principle, self-contained, such as the French Cour de Cassation's rulings, to being lengthy and full of references to academic literature as is the case in Germany (Quézel-Ambrunaz 2012, 108; Markesinis and Unberath 2002, pp. 9–12). They may look like unanimous and anonymous decisions of the court (civil law), or, as in common law, they may show the individualized opinion of individual judges, be they concurring or dissenting (van Dam 2013, pp. 53–5, 75–7, 95–7). Legal scholarship plays a role in (tort) law-making processes which is strong and evident throughout the continent except England (Bussani 2007a, p. 378). In continental Europe, tort law reasoning usually starts with the black-letter words that legislators use in codes and statutes, while in common law countries the same role is played by judicial doctrines hardened into precedents (Bussani and Palmer 2003, pp. 120–159).

Fault-based rules are presented everywhere as the foundation of the tort law system (Werro and Palmer 2004, p. 13), but they may either be open ended, attaching liability for any conduct which

causes damage to another (e.g., France, Italy, Poland), or may provide for liability only in certain situations, thereby restricting recovery to the breach of specific duties (typically England) or to the infringement/violation of a list of specific interests (such as Germany, Austria, Scandinavian countries) (von Bar 2009, pp. 229–33). General rules on fault liability may require the plaintiff to prove the defendant's negligence (Western Europe) or may state that once the damage is proved, the defendant's negligence is presumed (post-socialist countries) (Menyhárd 2009, pp. 350–2). Resort to strict liability rules may be made routinely (as in France) or as an exception (as is the case in England), with a range of intermediate positions (Werro and Palmer 2004, pp. 29–31). Vicarious liability for acts of a minor or an employee, which in German tort law is grounded in the responsible person's fault in supervision, is in the majority of the other jurisdictions imputed to him/her in an objective manner (Werro and Palmer 2004, pp. 393–6). Different from other European legal systems, in France (and to a certain extent in Belgium), the plaintiff is barred from suing the defendant(s) in tort if there is a contract between them (although the plaintiff can combine, in a single proceeding, actions in contract and in tort against different defendants) (Giliker 2010, p. 44; von Bar and Drobnig 2004, pp. 198–9). In Scandinavian countries, the impact of insurance on tort law mechanisms is more pervasive than anywhere else, effectively turning tort law into a residual remedy in many areas (Palmer and Bussani 2008, pp. 65–6; Bussani and Palmer 2003, pp. 156–8; Ussing 1952). Punitive damages and jury trials are available in England in an extremely limited number of cases but are almost unknown throughout the continent (Magnus 2010, pp. 106–7). European systems also diverge as to the (limited) extent to which they allow the procedural aggregation of victims' claims and contingency fee agreements between lawyers and their clients (see, respectively, Oliphant 2010, pp. 120–124, 163–164, 204–209, 287–288; Reimann 2012, pp. 3, 45).

Similarities and differences of course do not end there, but these illustrations suffice to make clear the great variety of European tort laws. It is a variety that at first sight – but at first sight only – may resemble the scenario in the United States, where increasing divergence between the federal and states' (tort) laws pushed the *American Law Institute* to launch, in the late 1920s of the twentieth century, the idea of the *Restatements of the Law*. Such a first impression presented by the analogy would, however, be wrong. There are considerable differences between the European case and that of the United States. We will not point out how punitive damages, jury trials, aggregation of claims, and contingency fee agreements are largely unknown to European tort laws, while they shape the basic vocabulary of tort law in the United States (Magnus 2010, pp. 102–24). There is more to it than this. Although the United States display 51 tort law jurisdictions, including the federal one, these regimes largely share a common language and employ the same reservoir of notions and technicalities. Most US legislatures are affected by the same pressures coming from power groups acting across state boundaries, like the insurance industry and the American Trial Lawyers Association. Moreover, the US Supreme Court, in matters it can intervene in, operates as a driving force for uniform outcomes (Palmer and Bussani 2008, pp. 52–3; Stapleton 2007, p. 25). Europe, by contrast, lacks one Supreme Court for private law matters. The insurance market is still not homogeneous, and lawyers are associated at the national level only. There is no common language, but 24 distinct ones, and every legal system relies upon its own set of notions and technicalities – a set that, as we just saw, may significantly overlap but may also greatly diverge among different jurisdictions.

Harmonization's Pros and Cons

As said above, the idea of harmonizing the variety of European tort laws for a long time did not attract the attention of institutions and scholars. Up until the 2000s it was monopolized by promoting legal convergence of contract laws, thought as the area that impacted business activities directly (Bussani 2007c; for the observation

that convergence would be easier in contract law rather than in tort law, insofar as contract laws are all inspired by the aim of facilitating trade, while tort laws are closely linked to domestic preferences as to what is to be protected (see Ogus 1999, pp. 412–7).

From the 2000s onward, things have changed. Although the EU has plunged into the field of liability insurance since the 1970s, the majority of statutory interventions on tort law have been adopted after the turn of the century (see below, section "The EU's Piecemeal Approach"). In the same period, books on comparative law of European tort law started to multiply (Infantino 2012; Bussani and Werro 2009; Bussani 2007b; van Dam 2006; Brüggemeier 2004; Bussani and Palmer 2003; Zimmermann 2003b; van Gerven et al. 2000; von Bar 1998, 2000), as did studies on the costs and benefits of tort law harmonization (van Boom 2009; Bussani 2007a; van den Bergh and Visscher 2006; Wagner 2005; Faure 2003; Hartlief 2002; Banakas 2002). Two scholarly projects aiming at drafting a text for a future European tort law –the *European Group on Tort Law*, established under the auspices of the German reinsurance company Munich Re, and the *Study Group on a European Civil Code*, generously financed by the EU – published their results in 2005 and 2006, respectively (see below, section "Striving for Harmonization: The European Group on Tort Law and the Study Group on a European Civil Code"). In 2010, the *European Centre of Tort and Insurance Law*, closely affiliated to the *European Group on Tort Law*, distributed the first issue of the *Journal of European Tort Law* (de Gruyter).

Despite the different perspectives taken by the initiatives, the EU institutions and the scholars who participate in striving-for-harmonization projects agree that simplifying the current diversity of national tort laws is an aim worth pursuing. The reasons put forward to support such a view are many. First, a single European tort law regime is thought to contribute toward achieving the wider goal of a common area for free movement of goods, services, capital, and people. Simplifying the current European tort law patchwork would avoid the risk of inhibiting the mobility of persons and goods by the different conditions for liability and amount of compensation (Magnus 2002, pp. 206–207). It would minimize the risk of European businesses' forum shopping in search for the jurisdiction with the lowest quality and liability standard, thus fending off pressures on states to engage in a race to the bottom (Faure 2003, pp. 47–51). It would also increase the attractiveness of the European market to non-European economic operators: Europe would be more business-friendly if economic actors only had to tackle one unified regime, instead of 29 (1 supranational and 24 national) (van Boom 2009, p. 438; Reg. n. 864/2007, whereas 16, 20). Additionally, it has been emphasized by the EU institutions that a harmonized scenario would facilitate courts' handling of trans-boundary torts, decrease the length and complexity of transnational litigation, and guarantee more uniformity between judicial outcomes (Reg. n. 864/2007, whereas 16, 20). Last but not the least, the EU Commission has underlined that a single tort law framework would allow insurers to better operate throughout the European Union and to establish and provide services in a freer manner (European Commission Directorate-General for Internal Market and Services 2007, pp. 47–8) – an observation echoed by scholars, who have stressed that the fragmentation of European tort law has a number of detrimental consequences for insurance enterprises operating within the single market (Wagner 2005, 1274).

This institutional and academic enthusiasm has not been supported by everyone. Many have criticized the claims upon which the very idea of harmonizing tort law is founded. They have pointed toward the lack of empirical evidence supporting the allegation that fragmentation of tort laws affects the free circulation of people and goods (van den Bergh and Visscher 2006, pp. 513–6; Faure 2003, pp. 44–7) and the establishment and movement of business in Europe (Wagner 2005, p. 1272; Hartlief 2002, p. 228). In this light, the true beneficiaries of the harmonization process would not be people and business but insurers and scholars themselves. On the one hand, tort law harmonization would reconcile the many legal surroundings to which European insurance companies currently adjust to and

would therefore lower insurers' barriers to entering and/or operating in multiple jurisdictions (Wagner 2005, p. 1274). On the other hand, the pro-harmonization movement would provide many scholars with a suitable avenue to enhance their own prestige, enabling them to promote their career, collect funding, and attract social, legal, and economic attention to their work (Infantino 2010, pp. 48–9; with regard to harmonization of laws in general, see Schepel 2007, pp. 187–8; Hesselink 2004, pp. 688–9).

Many have reminded that the benefits that harmonizing tort law may provide should be weighed against its possible costs, such as the difficulty in changing laws, the suppression of local preferences, and the abolition of any regulatory competition (van den Bergh and Visscher 2006, pp. 513, 516–8; Faure 2003, pp. 36–7, 59–66). There is indeed little doubt that for any harmonization plan to be effective, the new uniform tort law rules would have to be subject to the unifying control of one Supreme Court (Bussani 2007a, p. 377) and would need to be coordinated with the notions and solutions offered in other fields of law, including civil procedure, criminal matters, administrative remedies, and constitutional provisions (Bussani 2007a, pp. 365–8, 377; Faure 2003, pp. 45–6). Even if judicial review and coordination with the broader legal framework could be guaranteed, any top-down harmonization effort would put into circulation rules foreign to the tradition and heritage of some, if not all, legal traditions involved. Lack of familiarity with the new rules and their underpinning rationales, as well as the possible path dependency on deep-rooted local traditions, could lead to the defeat of any harmonization project (Bussani 2007a, pp. 373–7). Moreover, it has been noted by many that the idea of harmonizing European tort law would have to face the same issues that are raised by any harmonization endeavor at the European level. Such issues include policy and linguistic choices, the (lack of) competence of the EU institutions to harmonize private law in general, the political legitimacy of the drafters, and the feasibility and desirability of a European code in general (Giliker 2009, pp. 268–72; Bussani 2007a, pp. 371–3; Magnus 2002, pp. 208–212).

This is not the place to align with either one or the other side of the debate. The following pages will simply try to review how the EU institutions and scholars have contributed to the tort law harmonization discourse. Let us start with the EU's role.

The EU's Piecemeal Approach

According to the EU treaties, the EU does not have the general and comprehensive power to intervene in the field of tort law. The only competence assigned to the EU by the treaties with regard to tort law concerns the responsibility of Member States and of the EU itself in cases where they breach their obligations under the treaties (see Arts. 260(1), (2), and (3) and Art. 340(2) of the Treaty on the Functioning of the European Union). The task of judging the compliance of Member States and the EU institutions with the treaties is entrusted to the Court of Justice of the European Union, whose case law on this point has played an important role in shaping the states' liability across Europe (van Gerven 2009, pp. 32–3).

Yet the EU has, through time, carved out new competencies in the realm of tort law. It has done so through the adoption of statutory laws – mostly directives – aimed at harmonizing those segments of tort law that were deemed to most often cross national boundaries and/or affect the development of the internal market the most (von Bar 1998, pp. 401–7). The trend started in the 1970s with the directive on liability insurance, the objective of which was to establish a harmonized insurance system to facilitate people's free movement and guarantee compensation to persons injured in a Member State different from their own (Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations, and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, now replaced by the Commission Directive 2009/139/EU of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance). In 1985, a directive on products liability pursued consumer safety

through the adoption of a strict liability regime for producers of defective products (Council Directive 85/374 of 25 July 1985 on the approximation of the laws, regulations, and administrative provisions of Member States concerning liability for defective products). In 2004, two other directives introduced a common framework, respectively, for compensating crime victims (Council Directive 2004/80 of 29 April 2004 relating to compensation to crime victims) and for protecting the environment on the basis of the "polluter pays" principle (European Parliament and Council Directive 2004/35/CE of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage). On the assumption that cross-border externalities may be countered by harmonized rules of private international law, the EU enacted a regulation in 2007 enabling conflict of law rules to designate the law applicable to transnational tort claims (Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations). In 2013, the European Commission issued a recommendation on a set of common, nonbinding principles for collective redress mechanisms (Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in Member States concerning violations of rights granted under Union Law). The last act of the EU statutory series on tort law was a directive adopted (not yet formally) in 2014 and aimed at removing practical obstacles to compensation for victims of infringement of the EU antitrust law (Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of Member States and the European Union).

Some of the abovementioned reforms have apparently enjoyed a remarkable success, both within and outside the EU borders. Compulsory vehicle insurance, for instance, is now a reality throughout the EU. The directive on products liability has inspired many legislators around the world who preferred to follow the newly established EU model rather than the US model (Reimann 2003). Yet the actual effectiveness of the abovementioned EU laws is overall much debated. To illustrate, studies carried out on the insurance sector have pointed out that the liability regimes underlying compulsory insurance for traffic accidents are still diverging remarkably among European jurisdictions (van Dam 2013, p. 459). In a similar vein, it has been noted that, despite the external success of the products liability directive, the convergence created by the act has been minimal, and the rate of litigation grounded on the EU-branded products liability regime has remained incredibly low (Reimann 2014; Howells 2008).

Many reasons have been put forward to explain the limited effect of the EU's harmonizing strategy in the field of tort law.

A first explanation points to the piecemeal approach taken by the EU. The EU institutions have up to now kept themselves far from any intervention in the general architecture of substantive tort law. They implicitly assume that tort law can be divided into a core of general rules to be left to national jurisdictions and "special" rules where the EU legislation can effectively intervene (von Bar 1998, p. 408). Yet the "special" rules can only be applied within and through the framework of the general rules. This is why planting the seeds of a special EU discipline in national tort law frameworks risks being a bad strategy for achieving the goal of minimizing the differences between national tort laws (van Gerven et al. 2000, p. 10; von Bar 1998, p. 408).

Such a risk is increased by both the contradictory character of the EU patchwork of tort law statutory provisions and by the absence of a court entrusted with a general competence over the interpretation of those provisions (Koziol 2007, pp. 5–6; Koch 2007, p. 109; van den Bergh and Visscher 2006, p. 11; Faure 2003, pp. 56–7). Contradictions often arise within the EU legal framework itself, because the EU institutions lack, among other features, a common vocabulary and a standard terminology capable of summarizing the different notions arising from the European linguistic and legal plurality. Contradictions may

also appear within national legal contexts where the EU rules are to be implemented, due to the lack of homogeneity between the EU and national languages, concepts, and rules (von Bar 1998, pp. 387–9).

All the above flaws are said to be worsened by the very use of the directives as the EU's main legislative tool (Koziol 2007, pp. 5–6; Koch 2007, p. 109; von Bar 1998, p. 410). Directives have the virtue of flexibility, i.e., of guaranteeing that each state can adapt the EU acts into its national categories, but the flip side is that frequently the outcomes of the process of implementation diverge greatly due to the tendency of Member States to replicate the traditional features of their legal system into the implemented rules. Thus, directives may result in intensifying legal differences as opposed to supporting uniformity (van Gerven et al. 2000, pp. 9–10; for some concrete examples, see Infantino 2010, p. 58).

Resorting to regulations rather than directives is only a limited cure. With regard to the only regulation so far adopted in the tort law field – Reg. n. 864/2007on the law applicable to non-contractual obligations – it has been noted that many factors might hinder its uniform application. Divergence, for instance, may stem from the lack of agreement on the meaning of notions, such as "tort claim," "injury," "direct," and "indirect" consequences (Hay 2007, pp. 139–40, 144, 149). Differences may also arise from the well-known tendency of national jurists to interpret foreign law in light of their national notions, categories, and rules of law or to even apply to transnational cases their own national law, no matter what the conflict of law criteria says (Fauvarque-Cosson 2001, p. 412).

Scholarly Endeavors

The above considerations led many scholars to pave their own way toward a truly common European tort law.

Aims and methods of these endeavors are very dissimilar from one another. There are associations, such as the *Pan-European Organisation of Personal Injury Lawyers* (PEOPIL), whose purpose is the promotion of judicial cooperation between the European jurisdictions in personal injury litigation (see peopil.com). There are scholars who collect, translate, and make available cases from different European jurisdictions, on the assumption that the ability of European courts to engage in exercises of legal comparison when deciding cases might be the right path to achieve a truly, long-term harmonizing effect (Markesinis 2003, pp. 156–176; see also the database at utexas.edu/law/academics/centers/transnational/work_new/; a similar enterprise is carried out by the *Institute for European Tort Law* with its EUROTORT database, atectil.org/ectil/Eurotort.aspx). Two closely connected Austrian-based institutions – the *European Centre of Tort and Insurance Law* and the *Institute for European Tort Law* – provide a forum for research on comparative tort law and a venue for publication of up-to-date information and commentary about European tort law. The two institutions (which also support the *European Group on Tort Law*) organize an Annual Conference on European Tort Law every year, update a database of European case law on tort (see the EUROTORT database mentioned above), and publish many series on tort law and a peer-reviewed journal (the *Journal of European Tort Law*) (for more information, see ectil.org and etl.oeaw.ac.at).

Some projects, such as the *Ius Commune Casebooks* and the *Common Core of European Private Law*, are focused on the need for improving knowledge about the EU's legal systems. Other groups, such as the *European Group on Tort Law* and the *Study Group on a European Civil Code*, have engaged in ascertaining solutions that may best regulate certain legal problems and in codifying those solutions in the text of a would-be European code.

Given the breadth and significance of their work, it is the last four initiatives we mentioned that we will focus our attention on. We will begin with the striving-for-harmonization enterprises and then move on to those whose pivotal aim is building and developing better knowledge of European private laws.

Striving for Harmonization: The European Group on Tort Law and the Study Group on a European Civil Code

As anticipated, two scholarly groups that have thus far attempted to draft a text for a would-be codification on European tort law: the *European Group on Tort Law* and the *Study Group on a European Civil Code*.

The former group was established in 1992 within the Viennese *European Centre of Tort and Insurance Law*, whose main sponsor is the German reinsurance company Munich Re (for more information, see egtl.org and ectil.org). From 1992 to 2005, the group accomplished many studies, the results of which have been collected in a series called *Principles of European Tort Law* (PETL), published by Kluwer Law International (Widmer 2005; Rogers 2004; Magnus and Martín Casals 2004; Spier 1998, 2000a, b, 2003; Koch and Koziol 2002; Magnus 2001; Koziol 1998). Each volume gathered national reports and comparative results of an inquiry carried out on a specific tort law topic (e.g., causation, fault, wrongfulness, strict liability, etc.). Contributors were asked to describe the legal treatment of the assigned topic in their country by responding to some theoretical issues and by solving concrete cases; the editors then summarized the results (European Group of Tort Law 2005, pp. 14–16). The outcomes of the research were used as a starting point for drafting the PETL, which were published in 2005. The *PETL* are divided into ten chapters: Basic Norm, Damage, Causation, Liability Based on Fault, Strict Liability, Liability for Others, Defences in General, Contributory Conduct or Activity, Multiple Tortfeasors, and Damages (for a general overview of the contents of the PETL, see Oliphant 2009; Koch 2007, 2009; van Boom and Pinna 2008; Koziol 2007; van den Bergh and Visscher 2006; Zimmermann 2003). The group is currently working on a new edition.

The other project committed to shaping a would-be legislative text was the *Study Group on a European Civil Code*, founded in 1998 by Professor Christian von Bar. The *Study Group* has the more general purpose of drafting a European code on the whole of private economic law (von Bar 2001). In the *Study Group*'s view, the preparatory work on a European code had to be performed by scholars, who are the only ones endowed with the necessary expertise to conduct the essential basic research and to set up rules unaffected by the particularities of national interests; the legislator's role could begin only once the academic work of selecting the *Principles of European Law* (PEL) was completed (von Bar 1999). In 2006, the drafting of the tort law book for the would-be European code was completed. The *Principles of European Law on Non-Contractual Liability Arising out of Damage Caused to Another* were first issued online on the group's website at sgecc.net and then included, with minimal modifications, in the *Draft Common Frame of Reference* prepared by the *Study Group* for the European Commission in 2008 and officially published by Sellier in 2009. The PEL are composed of seven chapters: Fundamental Provisions, Particular Instances of Legally Relevant Damage, Accountability, Causation, Defences, Remedies, and Ancillary Rules (von Bar 2009; for a general overview of the PEL contents, see Oliphant 2009; Blackie 2009; Blackie 2007; Blackie 2003 p. 133).

The intention of both the above groups was to supply the European (and national) legislator (s) with a possible basis for a new codification. To accomplish this goal, the groups neither looked for the rules most widely accepted across European countries, nor did they select, among the existing rules, the ones deemed most suitable for Europe. Instead, the groups sought what was the "best" solution to tort law problems, regardless of whether this solution reflected principles already established within any European jurisdiction (von Bar 2009, pp. 229–38; European Group of Tort Law 2005, p. 15).

On many issues, the drafters of the PETL and of the PEL clearly agreed about what the "best" solution for Europe would be. Both the texts take fault as the general basis for liability (cp. Arts. 4:101 PETL and 1:101(1) PEL) and complement it with vicarious liability rules for employers (Arts. 6:102 PETL and 3:201 PEL) and parents/supervisors of minors and mentally disabled persons (Arts 6:101 PETL and 3:104 PEL). In the

PEL as well as in the PETL, not all interests of the plaintiffs are worthy of the same legal protection. While there is no doubt about the abstract recoverability of losses deriving from the infringement of life, bodily and mental integrity, human dignity, liberty, and property (cp. Arts. 2:102 PEL and 2:201–3, 2:206 PETL), in both the texts compensation of pure economic loss is restricted (cp. Arts. 2:101(2)–(3) PETL with 2:204–5, 2:207–8, 2:210–1 PEL). The PETL as well as the PEL stress that compensation is the primary function of tort liability (cp. Arts. 10:101 PETL and 6:101 PEL). Moreover, both the PETL and the PEL emphasize the need to take into consideration special features of tort law conflicts that can actually be brought under examination, calling for an application of their rules carefully tailored to all the relevant circumstances of the case (cp., for instance, Arts. 2:105, 3:103, 3:201, 4:102, 4:201, 10:301(2) PEL and 2:101, 3:103(3), 5:301, 6:101(4), 6:103, 6:202 PEL).

Yet in many other cases the PETL and the PEL consistently diverge from one another as to what the "best" solution is. For instance, under the PETL, minors and persons with mental disability are not exonerated from personal liability (Art. 4:102 PETL), while special rules are designed by the PEL for personal liability of minors and persons with diminished mental capacity (Arts. 3:103 and 5:301 PETL). There is no uniformity between the texts as far as no-fault liability is concerned. The PETL set forth a presumption of fault for evaluating harmful entrepreneurial activities (Art. 4:202(1) PETL) and impose strict liability on whoever engages in an abnormally dangerous activity "for damage characteristic to the risk presented by the activity and resulting from it" (Art. 5:101 PETL). By contrast, the PEL provide no presumption of fault but rather establish a set of strict liability regimes, specifically tailored to compensate the damage caused by the dangerous state of an immovable property (Art. 3:202 PEL), animals (Art. 3:203 PEL), defective products (Art. 3:204 PEL), motor vehicles (Art. 3:205 PEL), and dangerous substances or emissions (Art. 3:206 PEL).

As far as damage is concerned, the PETL give minimal guidance regarding the criteria for the (un)recoverability of pure economic losses (Art. 2:102(4) PETL), but are more detailed as to the conditions under which redress for pain and suffering may be justified (Art. 10:301 PETL). By contrast, the PEL devote six articles to the requirements for compensation of pure economic losses (Arts. 2:204–5, 2:207–8, 2:210–1 PEL; the circumstance led many scholars to observe that the PEL open the liability floodgates for pure economic loss to an extent that goes far beyond the accepted standards in most Member States: see Zimmermann 2009, p. 496; Wagner 2009, pp. 234–7; Eidenmüller et al. 2008) and do not restrict compensation for pain and suffering and impairment of the quality of life (Art. 2:101(4)(b) PEL).

According to the PETL, even when an interest is deemed worthy of protection, the judge has to take into account all the relevant circumstances of the case in order to determine whether or not the recovery is undesirable in light of other public interests or the necessary "liberty of action" of the defendant (Art. 2:102(6) PETL). To instill a similar pro-defendant flexibility, the PEL adopt a wider approach, allowing the judge to not only verify whether, in light of all the circumstances of the case, granting compensation would be "fair and reasonable" (Art. 2:101(2)–(3) PEL) but also to relieve the faulty defendant from liability when "liability in full would be disproportionate to the accountability of the person causing the damage or the extent of the damage or the means to prevent it" (Art. 6:202 PEL).

The list of divergence between the PETL and the PEL could go further. For instance, the PEL, but not the PETL, authorize the plaintiff to take precautionary measures so as to reduce the risk of damages (Art. 1:102 PEL) and to claim that the defendant disgorge the profits she has obtained from the wrongdoing (Art. 6:101(4) PEL). The PETL, differently from the PEL, allow the judge to disregard trivial damage, regardless of whether another remedy is available to the victim (Art. 6:102 PEL).

Such amount of disagreement between the two texts is indeed not surprising, considering the uncertainty that exists, even among law and economics scholars, as to what tort law model

(s) would best fit the European legal framework (van den Bergh and Visscher 2006, pp. 513–4, 521–40). Rather than the foreseeable differences of opinion between the PEL and the PEL on these issues, what is more interesting to note, in our perspective, is a critique of the methodology and policy agenda that both the projects have embraced. While both the PETL and the PEL, as scholarly by-products, have the merit of offering a concrete basis for the debate on the prospects of European tort law, their future implications are much less straightforward. Leaving aside the doubts about the legitimacy of the jurists involved in these initiatives to act as legislators (Wagner 2005, pp. 1283–4), as well as any concern on the feasibility and desirability of a European codification of tort law (on which see above, section "The Variety of European Tort Laws"), what should be stressed here is that the adoption of either set of rules would require practitioners, judges, and scholars in national jurisdictions to become accustomed to a completely new tort law pattern and to develop methods and techniques that would, more or less, be foreign to their legal tradition. At least in the short run, the lack of such traditional accumulation of methods and techniques would likely drive jurists not accustomed to that pattern to keep relying on their own legal culture and on their traditional repertoire of solutions and technicalities. Thus, a fundamental objection to the top-down imposition of, the not-so-common, principles is the risk of perpetuating the divergence that the harmonization process is precisely aimed to reduce (Bussani 2007a, p. 369).

Building Knowledge: The Ius Commune Casebooks for the Common Law of Europe and the Common Core of European Private Law Projects

Aware that solutions to the above issues are critical, other scholars pursued another path. "Knowledge-building" enterprises share the common view that top-down harmonization cannot be undertaken without the collateral support of bottom-up initiatives. Therefore, the real instrument and target for those who are seeking the establishment of a truly European tort law should be the development of a common legal culture, based on as much knowledge as possible of the legal experience of each European jurisdiction.

Irrespective of the uses to which knowledge may be applied, which may or may not include the pursuit of legal harmonization, knowledge building is both the starting point and the final aim of two projects whose scope is broader than the ones we just examined, insofar as their focus goes beyond tort law only. These two projects are the *Ius Commune Casebooks for the Common Law of Europe* and the *Common Core of European Private Law.*

The *Ius Commune Casebooks* initiative was launched in 1994 by Professor Walter van Gerven with the aim of producing a collection of casebooks covering each of the main fields of European law (on the aims and methods of such a project, see van Gerven 2002, 2007; Larouche 2000, 2001; van Gerven 1996). The long-term purpose of the *Ius Commune* project is to "uncover common general principles which are already present in the living law of the European countries" for the benefit of European students (van Gerven et al. 2000, p. 68). In this view, the casebooks are primarily conceived as teaching materials to be used in the curricula of law schools in order to promote a common European education.

As of now, seven volumes have been published by Hart (van Erp and Akkermans 2012; Micklitz et al. 2010; Beale et al. 2010; Schiek et al. 2007; Beatson and Schrage 2003; van Gerven et al. 1998, 2000), and many are forthcoming, on issues as diverse as labor law, law and art, constitutional law, judicial review of administrative action, conflicts of law, and legal history (see casebooks.eu). Two volumes concerning tort law have already been published (van Gerven et al. 1998, 2000); one of them (van Gerven et al. 2000) is under review for the second edition. Every casebook, whose table of contents and materials are partly accessible on the project's website, collates legislation, excerpts from books, articles, and, above all, cases from various jurisdictions – mostly from France, England, and Germany, which are considered as representative of the main European legal families. Materials

from other legal systems are included in the casebooks only if they present an original solution when compared to the above legal systems. These materials are accompanied by introductory and explicatory notes, stressing the similarities among European legal systems, and the impact of the EU law "as a driving force towards the emergence of a new *ius commune*" (see casebooks.eu/research.php). The casebooks are written by a task force composed of academics representing what are deemed to be the "main" European legal families (van Gerven et al. 2000, vi-vii). A distinctive feature of the project is that each task force member, instead of dealing solely with his/her national legal system, is charged with writing an entire thematic chapter, even if it refers to legal systems different from his/her country of origin or of education. This distribution of work guarantees that the final outcome is not a patchwork of national reports but rather the genuine result of a truly comparative effort.

The *Common Core of European Private Law* project, led since 1994 by Professors Mauro Bussani and Ugo Mattei, has a different target audience, methodology, and primary goal. The initiative aims to unearth what is common, and what is not, between the EU Member States' private laws, in order to provide a reliable description of the actual state of the art of the European multi-legal framework (for a general overview of the project, see Bussani et al. 2009; Bussani and Mattei 1998, 2000, 2003, 2007; Kasirer 2002, p. 417; Bussani 1998).

Unlike the *Ius Commune Casebook* project, which emphasizes the solutions given by the legal systems considered to be leading or paradigmatic, the *Common Core* project focuses equally on all the EU national legal systems. The research carried out under the *Common Core* initiatives is published as volumes in a dedicated series by Cambridge University Press (although some books have also been published by Stämpfli and Carolina Academic Press). Of the fifteen volumes published so far (Hondius and Grigoleit 2014; van der Merwe and Verbeke 2012; Brüggemeier et al. 2010; Hinteregger 2008; Cartwright and Hesselink 2008; Möllers and Heinemann 2008; Bussani and Mattei 2007; Pozzo 2007; Graziadei et al. 2005; Sefton-Green 2005; Werro and Palmer 2004; Kieninger 2004; Bussani and Palmer 2003; Gordley 2001; Zimmermann and Whittaker 2000), five deal with civil liability issues, such as recoverability of pure economic losses (Bussani and Palmer 2003), protection of personality rights (Brüggemeier et al. 2010), boundaries of strict liability (Werro and Palmer 2004), ecological damage (Hinteregger 2008), and pre-contractual liability (Cartwright and Hesselink 2008). Two other volumes on tort law, causation, and products liability, respectively (see common-core.org), are under preparation.

On the shoulders of Rudolf B. Schlesinger's and Rodolfo Sacco's path-breaking research (Schlesinger 1968, 1995; Sacco 1991), the *Common Core* adopts a method based on the so-called factual approach as underpinned by the dissociation of legal formants. At the very foundation of the *Common Core*'s efforts, there is the following set of assumptions. Legal systems are not always made up of a coherent set of principles and rules, as domestic jurists tend to assume. What the rules say often does not relate to what the very same rules translate to in practice. Legal actors at work in the same legal system – the bar, the bench, scholars, lawmakers, insurers, bureaucrats, and so on – do not always offer the same account and interpretation of what legal rules are. Further, circumstances that are officially ignored and considered to be irrelevant in the application of the law often operate in secrecy, slipping in silently between what law is said to be and how it is actually applied (Bussani and Mattei 1998, pp. 343–5).

The need to delve into the depths of legal systems, and to obtain comparable answers from jurists from different jurisdictions, led the *Common Core*'s General Editors to adopt questionnaires as their key methodological tool. The research work develops as follows: when a topic is chosen, the person charged with the task of editing a volume on that particular topic drafts a factual questionnaire and distributes it among the national rapporteurs participating in the project. The questionnaire has a sufficient degree of specificity as to require respondents to address all the factors that have a practical impact on the legal

system they are analyzing. This method also guarantees that national responses surface how apparently identical black-letter rules may in fact produce different applications. The use of fact-based questionnaires also allows understanding whether and to what extent solutions depend on legal rules outside the private law field, such as procedural mechanisms, administrative schemes, or constitutional provisions, or on other factors, e.g., policy considerations, economic reasons, and social values, affecting the law-in-action level (Bussani and Mattei 1998, pp. 351–4). Responses to the questionnaires are publicly analyzed, discussed, compared, and subsequently collected by the topic editor of a volume in a book, which is published in the *Common Core* series.

There are many data that attest to the success of these two initiatives. The *Ius Commune* casebooks have been adopted in the curricula of European law faculties and have been quoted by national courts in their domestic tort law opinions (see some illustrations on casebooks.eu/project/aim/). *Common Core* volumes are widely cited by judges and scholars across and beyond European jurisdictions, and some of them have even been translated in languages other than English (see, e.g., Bussani and Palmer 2005). Yet, besides the number of books published and the amount of quotations these books get, the most important outcomes of the *Ius Commune* and the *Common Core* projects lie in the acculturation processes they trigger and in the transformations they help to bring about in European legal systems. These processes and transformations run deep in European legal cultures – so deep that their effects, although not easy to quantify in the short run, promise to be the most long-lasting ones in the long run.

Conclusions

Any assessment of the harmonization perspective in a given field must indeed take into account the time factor.

There can be no doubt that European tort laws, as defined by statutory texts, judicial precedents, and/or scholarly writings, and ultimately applied by courts to the disputes brought before them, display many lines of convergence. Yet tort law does not live in parliaments, law firms, courts, and law books only. It also lives "in the shadow" of the official systems of adjudication. It lives in the offices of insurance companies, which provide coverage for damages caused by the insured or third parties. It lives in people's notions about injury and risk, responsibility, and justice, determining people's conducts in day-to-day activities and their litigation/non-litigation choices once a wrong has occurred. Tort law lives in languages, concepts, and images associated with law in mass-generated popular culture – newspapers, television, movies, and novels – as well as in public debates about what values should be protected and promoted, at what costs, and at whose expense (Bussani and Infantino 2015; Oliphant 2012). This stratified set of individual and mass responses to injury, risk, and responsibility does not stand still. Its different constituents may change over time, moving in the same place at different speeds and in different directions (Bussani 2007a, pp. 369–70).

When dealing with the prospects of a soon-to-be harmonized European tort law framework, one should take time seriously. Harmonization efforts – whether hard or soft, legislative or scholarly driven, or aimed at immediate uniformity or at knowledge building – usually trigger a variety of transformations in the layers of a legal system. The time, speed, and direction of these transformations can widely diverge and are usually very difficult to predict, as is the way in which the transformations affecting one layer will interact with other layers of the system. The only dynamic that can be easily foreseen is that the more abrupt the requested change and the larger its departure from the legal culture where it should take place, the greater would be the time and cost needed by that legal system to adjust to the new framework – no matter how efficient it would be.

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Harmonization: Consumer Protection

Franziska Weber
Faculty of Law, Institute of Law and Economics, University of Hamburg, Hamburg, Germany

Abstract

This contribution gives an overview of law and economic works on consumer protection. It does so by taking three complementary angles: (1) assessing harmonization efforts regarding consumer protection in Europe, (2) presenting selected topics of substantive consumer law, and (3) analyzing the European consumer law enforcement from an economic point of view.

Synonyms

Consumer law; Consumer legislation; Consumer policy

Introduction

Consumer protection laws refer to a set of rules aimed at stipulating and guarding consumers' rights. It is a challenging field and requires knowledge of different legal areas (contract law, tort law, regulatory law, competition law, etc.) because consumer problems by nature lie at the borderline of private/public problems and social/commercial ones. Substantive consumer laws encompass public and private law, which is why redress is necessarily made to both public and private enforcement instruments. Whereas harmonization efforts at the European level have historically primarily concerned substantive consumer laws, European legislation increasingly aligns procedural laws also.

This contribution is structured as follows: Section "The Legal Approach and Its Economic Analysis: Research on Consumer Behavior" gives a short introduction to research into consumer behavior. Section "Harmonizing the European Consumer Law" starts with an economic analysis of harmonizing consumer law throughout Europe. It then brings into focus selected topics of consumer protection more specifically. On top of the substantive law dimension, a condensed economic analysis of the European consumer law enforcement is presented. Section "Conclusion" concludes.

The Legal Approach and Its Economic Analysis: Research on Consumer Behavior

The consumer movement started developing in the 1960s and 1970s. Advocates of this movement

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took the consumers' weaker position for granted and, therefore, strongly favored strengthening consumers' rights. Up until today the paternalistic consumer protection argument continues to be used when it comes to justifications for passing legislation in the field of consumer law (Micklitz et al. 2010, p. 1).

Whereas the term protection hence implicates a paternalistic element, an economic insight into consumer markets is the fact that increased consumer protection comes at the cost of higher product prices (Faure 2008). Typically an intervention in the market will lead to costs for the producer, such as increased expectancy of damage payments. It is therefore straightforward that these costs will be reflected in the product's price. Consequently, any legal intervention needs to be justified by the existence of a market failure. The most commonly occurring market failure in consumer law is information asymmetries, such as quality uncertainty (Akerlof 1979; Van den Bergh 2007a). The debate on consumer policy in law and economics in elaboration of the neoclassical approach has taken three different theoretical angles: information economics, new institutional economics, and behavioral economics (Rischkowsky and Döring 2008). In information economics the notion of asymmetric information is prevalent. The consumer is regarded as unable to appropriately perceive quality differences (Stigler 1961; Stiglitz 2000). A lack of information on the consumers' side and the resulting information costs impact on the consumers' decision-making process. This may be cured by providing consumers with more information. New institutional economics, on the other hand, acknowledges that the pure provision of information is not sufficient and calls for regulation of certain institutions (e.g., contracts). It expands the focus to looking at institutional arrangements in place to cure information asymmetries and deals more closely with specific rules. New institutional economics is more broadly concerned with transaction costs (Williamson 1975) – not only information costs – that impact market transparency and consumer behavior. Another core notion of this stream of economics relevant also to consumer behavior is that of "bounded rationality" (Simon 1957). According to this concept individuals, even if presented with all necessary information, are unable to correctly process it due to the limited capacity of the human brain to do so. Behavioral economics challenges the rational choice theory even more radically by showing that consumers – even when exposed to complete information – cannot successfully process it (Kahneman et al. 1982; Sunstein and Thaler 2009). Consumers are shown to systematically deviate from rational behavior. Behavioral economics provides insights on how consumers perceive and use available information and act in the presence of choice. Perception is dependent on consumers' internal constraints in the form of cognitive, emotional, and situational factors (Luth 2010). A notion put forward within behavioral economics is that of libertarian paternalism (Thaler and Sunstein 2003) – a form of paternalism that protects people from making bad choices by not employing coercion.

Consumer research is being carried out within all of these disciplines, with behavioral economics being the most recent and most popular one (Vandenberghe 2011; Sunstein and Reisch 2014). In the last years policy-makers and lawmakers at the European or Member State (MS) level and also, for instance, in the United States start to take more account of such evidence. Whereas insights are regarded as very valuable to understand real consumer behavior, some challenges need to be overcome still before strong normative conclusions may be drawn. There is, for instance, evidence of cognitive biases pointing in opposite directions; furthermore behavioral economics keeps lacking a framework to systematically use its insights for policy-making (Vandenberghe 2011). It is an unresolved matter how general conclusions can be drawn from a limited set of experiments. Note should be taken of the fact that marketing research has long dealt with better understanding consumer behavior (for an early contribution, see Kotler 1965).

Given its importance in the European context, it should be mentioned that much of the consumer law research is carried out from the angle of comparative law and economics, as the name suggests the intersection between comparative law and the

economic analysis of law (e.g., Faure et al. 2009; Kovac 2011; Weber 2014).

Harmonizing the European Consumer Law

Once an economist has identified a market failure, this paves the way to some type of – cautious or intrusive – legal intervention. One decision to be taken is, consequently, the type of legal intervention – e.g., imposition of information duties. A layer additionally complicating the nature of passing consumer laws in Europe is the availability of various lawmakers: For the European Union (EU), the competences are generally either situated at the MS level or at the Union level. Not all Union legislation, furthermore, leads to the same degree of unification within Europe. A starting point would be whether a regulation, directive, or other instrument is chosen; legal instruments can aim at different levels of harmonization.

The legal basis stipulating law-making competences does not necessarily coincide with economic theory on the desirable level of law-making powers at all times. The trade-off between centralized and decentralized decision-making has been assessed from the point of view of "economics of federalism" (Oates 1972) and "regulatory competition" (Ogus 1999; Van den Bergh 1994, 2000, 2002), also specifically for the European consumer law (Van den Bergh 2007b; Faure 2008). The concepts can be used to give meaning to the principle of subsidiarity (Van den Bergh 1994) and identify the adequate level of law-making. Competition between different laws is regarded as desirable as it enables citizens to choose the jurisdiction according to their preferences (Tiebout 1956). Differences, furthermore, may facilitate learning between the states. Decentralized rule-making may have advantages in terms of being better able to tailor legislation to preferences, and local authorities may have an information advantage regarding local specificities (Van den Bergh 2007b). Reasons to harmonize on the other hand are the need to internalize interstate externalities, the potential danger of a race to the bottom, economics of scale, and the reduction of transaction costs. Another factor to be taken into consideration is political distortions that depend on the strength of lobby groups at the various levels (Van den Bergh 2002).

The findings will differ for the area of law considered. Regarding the case of consumer protection laws, the discussion on the adequate level of law-making and the need for harmonization was recently steered up again by the Consumer Rights Directive (Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, OJ L 304, 22.11.2011, pp. 64–88). According to the original draft proposal, four directives previously aiming at minimum harmonization were to be changed into maximum harmonization (Faure 2008). (The directives concerned are Directive 85/577/EEC on contracts negotiated away from business premises, Directive 93/13/EEC on unfair terms in consumer contracts, Directive 97/7/EC on distance contracts, and Directive 1999/44/EC on consumer sales and guarantees.) This original proposal triggered heavy criticism by law and economics scholars (Van den Bergh 2007b; Faure 2008), providing strong arguments against full harmonization and instead pleading in favor of diversity: mainly because preferences of consumers in the MS diverge a lot, not least based on differences in income levels. The final text of the Consumer Rights Directive does not claim maximum harmonization as strongly as the first draft. It is said to having been watered down to "some kind of quite undefined 'targeted' (i.e., partial or incomplete) full harmonisation" (Gomez and Ganuza 2012). Its content concerns primarily information duties for distance, off-premises, and other contracts and the right of withdrawal for distance and off-premises contracts (see recital 9).

Substantive Law Dimension

There is a growing body of research discussing the costs and benefits of consumer protection laws (Cseres 2012). Recent collections of law and economics work on contract law were published in the context of discussing the Draft Common Frame of Reference (Wagner 2009; Larouche and Chirico 2010); some contributions deal more specifically with consumer protection clauses

(Luth and Cseres 2010 and for the Common European Sales Law, Bar-Gill and Ben-Shahar 2013).

Much of consumer law is written as mandatory laws; other consumer protection provisions are stipulated as default rules. From a legal point of view, there is no clear normative stance identifying a preference for one type over the other; apparently the protection aspect plays an important role. From a law and economics point of view, certain costs and benefits of both types of rules have been identified. It is crucial that mandatory rules prevent "sharper deals forgone" by consumers who would have abstained from enjoying certain types of costly consumer protection rules; however, they are prohibited by law from doing so (Mackaay 2013, p. 423). This factor, on top of the costs of enacting and enforcing such a rule, needs to be weighed against potential benefits. For default rules the costs are different as opting out of the default is possible and may lead to costs (Mackaay 2013). In addition, the default may end up being unsuited or deviation may practically be impossible. Law and economics literature has dealt extensively with the question of what the default should be (Ayres 2012). In the first wave of this literature, the view prevailed that the default rule should be the one that the majority would have chosen as this would reduce total costs. A second stream of literature concerned a debate on whether there is such a thing as a penalty default or information-forcing default. Such a rule basically punishes the non-deviating party by, for instance, granting his/her a high interest rate only if he/she does not reveal certain information. Lately, not least under the influence of behavioral law and economics, the debate has turned toward the design of different default rules – personal default rules or those enabling active choice (Sunstein and Reisch 2014) – and the notion of "altering rules," i.e., the rules that set out how one can deviate from the default option (Ayres 2012). Cognitive biases are used to illustrate how certain types of formulations and conditions to deviate from the default affect behavior. Some rules can be regarded as "sticky," i.e., choice is only an illusion. These findings play in the context of all types of mandatory and default rules that may be relevant for consumer protection.

Standard contract terms in consumer contracts have specifically attracted scholar's attention. There are empirical studies confirming that consumers do not read these terms (e.g., Bakos et al. 2014) and publications discussing the consequences of this insight for policy-making (Luth 2010). An empirical study regarding the content of such terms in the context of software companies, for instance, confirms a bias toward terms favoring the contract writer – in this case the software company (Marotta-Wurgler 2007). The basic market failure asserted is that of an information asymmetry (Schäfer and Leyens 2010). Due to the consumer not being able to observe the terms and condition's quality, quality may overall decrease, driving good terms out of the market. A consequence that may be drawn is that a judicial control of standard terms is desirable for certain types of contracts.

Further research concerns the costs side of a right of withdrawal (Eidenmüller 2011). One such cost may be a potential moral hazard problem (Rekaiti and Van den Bergh 2000). Unsurprisingly, given that a lot emphasis is put on the problem of information asymmetries between consumers and the opposite party, information disclosure rules are an important aspect of consumer protection law (Beales et al. 1981; Eisenberg 2003; De Geest and Kovac 2009, and from a comparative law and economics point of view: Kovac 2011). Law and economics has furthermore dealt with the topic of warranty contracts and their different functions being that of insurance, a quality signal and acting as an incentive to provide high quality (Emons 1989; Werth 2011). The classical consumer topic "unfair commercial practices" is dealt with from an economic point of view by Gómez (2006). Within the scope of this short overview, it is not possible to set out all the research that has been carried out (see for a broader overview Cseres 2012). Suffice it to say that also advertising and banking laws have attracted scholarly attention.

Law Enforcement Dimension

From an economic viewpoint, the threat of enforcement steers people's behavior, more particularly, their incentives to obey the law. The

interplay between substantive laws and their enforcement forms the incentives and deterrents that induce law-abiding behavior. Law and economics scholars traditionally discuss enforcement matters from the angle of *Becker's* deterrence theory developed for criminal law (Becker 1968). According to the deterrence theory, a rational wrongdoer can be induced not to violate the law if the sanction for a potential wrongdoing (multiplied by the probability of detection and conviction) is at least as large as the benefit he/she could obtain from committing the wrong. Meanwhile, this approach has been expanded to law enforcement more broadly.

There are a number of different enforcement mechanisms at play in consumer law, and group litigation is a powerful procedural tool. Law and economics scholarship is long to realize that, for instance, classical public and private enforcement schemes clearly each have a number of economic strengths and weaknesses (Shavell 1993; Van den Bergh 2007a; Faure et al. 2009; Weber 2014). Crucial economic factors at play when assessing whether individuals will initiate a lawsuit or report a wrong are the following: Due to "rational apathy" an individual will not act if the costs of doing so outbalance his/her benefits, for instance, when harm is very small and the investment to enforce the law is costly (Van den Bergh 2007a). If societal harm is nevertheless large, no action may be taken because of a divergence between the individual and social incentive to sue (Shavell 1997). The other extreme is "frivolous lawsuits" that are not based on merits and socially not desirable. Another possible distortion of incentives concerns "free-riding" problems. This problem can occur if in certain situations, in which many victims suffer from a law infringement but all gain as soon as one of them sues, it is efficient for everybody to wait for someone else to sue and then profit from the result (Van den Bergh and Visscher 2008a, p. 14). As mentioned information asymmetries are the core market failure in consumer law, e.g., unobservable characteristics of a consumer good. For the enforcement side it is furthermore true that they are one of the key triggers of litigation. Law enforcement mechanisms/procedures are therefore also discussed regarding the extent to which they mitigate these asymmetries by generating information. Investigative powers are a main means to achieving this. Continuing to think along the lines of enforcer's incentives to carry out tasks as desired, literature discusses capture as an incentive problem, meaning the exertion of influence on public administration that leads to public officials pursuing, e.g., industry interests (Ogus 1994, p. 57). This concept can be expanded to other enforcers. Principal-agent problems are another matter discussed in this literature. In these relationships the principal (e.g., a client) cannot fully control the quality of the agent's (e.g., lawyer's) performance (Shavell 1979). The basis for any principal-agent problem is an information asymmetry between two parties, which can lead to moral hazard. Lastly, two additional types of costs are decisive: Error costs refer to courts taking mistaken decisions. Error costs can generally be divided in two groups: Error I costs are those that occur when an individual who is guilty might mistakenly not be found liable ("mistaken acquittal"). Error II costs on the other hand occur if an innocent individual might mistakenly be found liable ("mistaken conviction"). Administrative costs then refer to all costs incurred by having a particular enforcement system in place, which in reality is challenging to measure.

By way of example, private law enforcement, if litigation costs are substantial, may suffer from people being rationally apathetic, and depending on the remedy that is sought, "free-riding" may be an issue. Public law enforcement scores highly when it comes to reducing information asymmetries by having investigative and monitoring powers in place. It is generally differentiated between judges that are less likely to be captured compared to public officials, self-regulatory institutions, or certain group representatives. Group litigation, if designed well, is able to reduce rational apathy problems, same as "free-riding" problems. However, capture may be an issue, same as a more complex principal-agent structure and high administrative costs. Criminal law on the other hand may deter even judgment-proof wrongdoers, those that are insolvent, by unique sanctions such as imprisonment (Bowles et al. 2008). Again, administrative costs are

presumably high, same as investigative powers would be. Error costs are discussed as a concern in particular for administrative law enforcement as opposed to criminal law enforcement. In conclusion the optimal solution might be to create a mixture of public and private enforcement that draws upon their comparative advantages (Van den Bergh 2007a; Faure et al. 2009) – the so-called optimal mix of public and private enforcement. Furthermore this mix needs to vary for different sectors of consumer law. Therefore recent research attempts to design optimal enforcement mixes concretely for certain consumer violations by arguing along the lines of the different established economic criteria (e.g., safety laws (Van den Bergh and Visscher 2008b), misleading advertising and package travel (Weber 2014)).

The allocation of enforcement between various mechanisms is one of four crucial parameters of law enforcement, according to law and economics literature (Shavell 1993). The other three are the optimal sanction (injunction, administrative fine, criminal fine), the optimal timing of the intervention (ex ante monitoring and/or ex post enforcement), and the optimal governmental level – either centralized or decentralized – to house the enforcement powers (see also section "Harmonizing the European Consumer Law"). Needless to say, the parameters are heavily interlinked and cannot be discussed in isolation.

At the EU level various legal initiatives in the context of consumer law enforcement are ongoing: alternative dispute resolution and online dispute resolution (legislative proposal for a Directive of the European Parliament and of the Council on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Directive on Consumer ADR), Brussels, 29.11.2011 COM (2011) 793 final and proposal for a Regulation of the European Parliament and of the Council on online dispute resolution for consumer disputes (Regulation on Consumer ODR), Brussels, 29.11.2011 COM(2011) 794 final 2011/0374 (COD)), same as collective redress. (See Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law OJ L 201, 26.7.2013, p. 60–65, Communication from the Commission "Towards a European Horizontal Framework for Collective Redress", C(2013) 3539/3.) The EU has, furthermore, strengthened the public law dimension with the Regulation on Consumer Protection Cooperation. (See Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws (the Regulation on Consumer Protection Cooperation).) These initiatives found their echo in scholarly writing (Keske 2010; Van den Bergh 2013; Wagner 2014) and also stressing the need to take due account of MS's differing traditions when suggesting EU-wide legislation (Weber 2014). Implementation costs of the EU legislation vary for each MS depending on the prevalent enforcement tradition (Ogus 1999; Faure 2008). Countries are "path dependent" which is why deviating from their tradition may incur costs that need to be weighed against benefits of a new law.

Conclusion

Increasingly, law and economics scholars are looking into consumer protection matters. Research thereby takes various angles. One aspect concerns the questionable desirability of harmonizing consumer laws throughout Europe. Secondly, scholars assess typical consumer law topics, such as standard contract terms or duties of information disclosure from an economic perspective. Thirdly, research is ongoing regarding the fine-tuning, mixing, of different enforcement mechanisms in consumer law. Consumer research is increasingly carried out within behavioral law and economics. Furthermore studies take due account of the importance of comparative law which is particularly crucial in the context of EU law-making. It is important to suggest new European legislation in awareness of existing enforcement traditions in the MS.

In terms of future research, two main challenges can be identified: Firstly, the question on

how far behavioral insights should be translated into policy- and law-making needs answering, and a framework to doing so would need to be established. Secondly, when passing consumer legislation at the European level, it is crucial to identify each time to what extent harmonization is indeed desirable. In this overall cost-benefit assessment, an important factor to be considered is implementation costs which stem from countries' path dependencies. This is a key to avoiding inadequate European legislation.

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Harmonization: Legal Enforcement

Katalin J. Cseres
Amsterdam Centre for European Law and Governance, Amsterdam Center for Law and Economics, University of Amsterdam, Amsterdam, The Netherlands

Abstract

While harmonization and convergence of national substantive laws are well advanced in the European Union, a similar convergence and harmonization of the procedural rules and institutional frameworks has not taken place. The implementation, supervision, and enforcement of EU law are left to the Member States in accordance with the so-called national procedural and institutional autonomy. This "procedural competence" of the Member States means that the Member States have to provide remedies and procedures governing actions intended to ensure the enforcement of rights derived from EU law.

Harmonized substantive rules are implemented through diverging procedures and different kinds of enforcement bodies, but this decentralized enforcement challenges the coherent and uniform application of EU law. In an enforcement system where Member States apply divergent procedures, may impose a variety of sanctions and remedies administered by various actors the effectiveness of EU law, effective judicial protection and effective law administration may be at risk. This chapter analyzes the development of EU law

concerning law enforcement and takes a critical look at the EU's aim to harmonize the national procedural rules when EU law is enforced. It will examine the question of which legal basis can be used in order to harmonize procedural rules, whether harmonizing procedural rules would be more efficient than the existing legal diversity and the economics of harmonization will be applied to assess the top-down harmonization by the EU and comparative law, and economics is applied to evaluate the bottom-up voluntary harmonization of the Member States.

Introduction

The implementation, supervision, and enforcement of EU law are left to the Member States in accordance with the so-called national procedural and institutional autonomy. This "procedural competence" of the Member States means that the Member States have to provide remedies and procedures governing actions intended to ensure the enforcement of rights derived from EU law, provided that the principle of equivalence and the principle of effectiveness are observed. (*Case 33/76, Rewe-Zentralfinanz eG and Rewe-Zentral AG* v *Landwirtschaftskammer für das Saarland (Rewe I)*, [1976] ECR 1989, para 5.) Competence allocation in the European multilevel governance is politically sensitive (Bakardjieva-Engelbrekt 2009; Cafaggi and Micklitz 2009; Van Gerven 2000), and as such, it has been extensively discussed in the literature and in the case law of the European courts (Jans et al. 2007). (Case C-410/92, *Johnson* [1994] ECR I-5483, para. 21; Case C-394/93;, *Unibet (London) Ltd and Unibet (International) Ltd.* [2007] ECR I-2271, para 39; Joined Cases C-430/93 and C-431/93 *Van Schijndel and van Veen* [1995] ECR-i4705; Joined cases C-295/04 to C-298/04 *Manfredi v Lloyd Adriatico Assicurazioni SpA and Others* [2006] ECR para 62.) This discussion has mainly addressed the competence allocation between the Member States and the EU and the increasing influence of EU law and policy with regard to procedural and remedial autonomy (Delicostopoulos 2003; Kakouris 1997; Lenaerts et al. 2006; Prechal 1998; Trstenjak and Beysen 2011; Reich 2007; Van Gerven 2000). It has, however, not addressed the question to which authorities of the Member States allocate regulatory powers for the enforcement of EU law and how they organize and structure these enforcement agencies in their national administrative law system. (Institutional autonomy is the Member States' competence to design their own institutional structure and allocate regulatory powers to public administrative agencies that enforce EU law (Verhoeven 2010). In *International Fruit Company II*, the CJEU has stated that

> [A]lthough under Article 5 of the Treaty the Member States are obliged to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the Treaty, it is for them to determine which institutions within the national system shall be empowered to adopt the said measures [. . .] when provisions of the Treaty or of Regulations confer power or impose obligations upon the states for the purposes of the implementation of Community law, the question of how the exercise of such powers and the fulfilment of such obligations may be entrusted by Member States to specific national bodies is solely a matter for the constitutional system of each state

Joined cases 51–54/71 *International Fruit Company II* 15 December 1971: [1971] E.C.R. 1107. paras 3–4.)

While harmonization and convergence of substantive laws are well advanced, a similar convergence and harmonization of the procedural rules and institutional frameworks have not taken place. In the following sections, first the development of EU law concerning law enforcement will be examined, and then a critical look is taken at the EU's aim to harmonize the national procedural rules when EU law is enforced. First, it will be examined whether legally it is feasible, i.e., what legal basis can be used in order to further harmonize procedural rules. Second, it will be examined whether harmonizing procedural rules would be more efficient than the existing legal diversity. The economics of harmonization will be applied to assess the top-down harmonization by the EU and comparative law, and economics is applied to evaluate the bottom-up voluntary harmonization of the Member States.

Development of EU Law on Law Enforcement

In the EU Member States, highly convergent and harmonized substantive rules are implemented through diverging procedures and different kinds of enforcement bodies. This decentralized enforcement poses a challenge to the coherent and uniform application of EU law. In an enforcement system where Member States apply divergent procedures and may impose a variety of sanctions and remedies administered by various actors, the effectiveness of EU law, effective judicial protection (Articles 6 and 13 of the ECHR, Article 47 of the Charter of fundamental rights of the European Union which has now been reaffirmed in Article 19(1) TEU), and effective law administration may be at risk. In EU competition law, for example, it has been questioned whether consistent policy enforcement and the effective functioning of the European Competition Network require a certain degree of harmonization of procedures, resources, experiences, and independence of the NCAs (Bakardjieva-Engelbrekt 2009; Cengiz 2009; Gauer 2001; Frédéric 2001). Similarly, in consumer law, the Unfair Commercial Practices Directive 2005/29 has allowed the Member States to establish their own specific enforcement systems. The national enforcement regimes are very diverse: some Member States have predominantly private enforcement; others rely predominantly on public bodies. In accordance with the principles of procedural and institutional autonomy, the Member States can entrust public agencies or private organizations with the enforcement of consumer laws, enabling those institutions to decide on the internal organization, regulatory competences, and powers of public agencies (Balogh and Cseres 2013). The variety of national enforcement architectures is remarkable in light of the far-reaching harmonization goal of the Directive. Moreover, the broader institutional framework comprising of locally developed enforcement strategies may further differentiate the Member States' enforcement models.

The following two sections will first examine which developments have taken place toward harmonization of law enforcement in the EU and then examine the economic rationale of such harmonization.

Europeanizing Law Enforcement

The influence of EU law on Member States' procedures and remedies of law enforcement has been gradually growing since 1992 (de Moor-van Vugt 2011) and has been intensified when enlargement to the Central and Eastern European countries in 2004 took place (Bakardjieva-Engelbrekt 2009). According to Nicolaides, enforcement became a priority area of EU policy with the process of enlargement due to the fact that, first, the CEECs emerged from many years of communism and they had to build institutions that were accountable to citizens and functioned in very different environments than in the past. Second, EU integration has progressed, and the impediments in the internal market were found in administrative weaknesses and incorrect implementation of EU law. Third, the legal body of the *acquis* expanded considerably, especially in the area of internal market, and it made proper enforcement key to make the single market work (Nicolaides 2003, pp. 47–48).

De Moor-van Vugt has identified patterns in the Europeanization of law enforcement. She shows that as from the early 1990s, the Commission began to monitor the Member States' enforcement of EU law due to insufficient implementation of EU law resulting in fraud with EU structural funds (de Moor-van Vugt 2011). As a result, the Commission implemented a stricter policy which limited the Member States' procedural autonomy and obliged them to comply with the principles of sincere cooperation, non-discrimination, and effectiveness (de Moor-van Vugt 2011). The CJEU's judgment in *Greek Maize* opened the way for the Commission to lay down obligations for the Member States in consequent directives and regulations that concerned subsidies in order to take appropriate measures in case of infringements of EU law. (Since the CJEU's judgment in C-68/88 *Greek Maize* the Member States are required by Article

4 (3) TFEU to take all measures necessary to guarantee the application and effectiveness of EU law. While the Member States remain free to choose the appropriate enforcement tools, they must ensure that infringements of EU law are penalized under conditions, both procedural and substantive ones, which are analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty *effective, proportionate*, and *dissuasive.* Case 68/88 *Commission v Hellenic Republic*, Judgment of the Court of 21 September 1989, I-2965, paras 23–24.) De Moor-van Vugt demonstrates that the same pattern of Europeanizing national enforcement models has been followed by the EU in several other sectors such as agriculture, environmental law, financial services, and sector regulations such as telecom and energy (de Moor-van Vugt 2011, p. 72).

The process of Europeanizing enforcement was well visible in the modernization of EU competition law from the late 1990s and further since Regulation 1/2003 entered into force in 2004. The improvement of cross-border enforcement laid also at the heart of the Regulation 2006/2004 on consumer protection cooperation. (Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection, O.J. L 364/1, 9.12.2004.) This Regulation has set up an EU-wide network of national enforcement authorities and enabled them to take coordinated action for the enforcement of the laws that protect consumers' interests and to ensure compliance with those laws.

Similarly, in the liberalized network industries, the EU gradually extended the EU principles of *effective, dissuasive*, and *proportionate sanctions* as formulated in the case law of the European courts to a broader set of obligations and criteria for national supervision in EU legislation. The liberalization of state-owned enterprises has been accompanied by the obligation for Member States to create regulatory agencies in order to maintain elements of public control and to provide reassurance of independence from government in creating a level playing field for new entrants (Gorecki 2011; Scott 2000; Thatcher 2002).

Europeanizing market supervision (Ottow 2012) in the liberalized network industries also obliged Member States to establish independent national regulatory agencies with core responsibilities for monitoring markets and safeguarding consumers' interests (Micklitz 2009). Member States have strengthened the role of regulatory agencies and have empowered them with a growing number and diversity of regulatory competences. In law enforcement, a shift has taken place from the state to individuals and their collectives and also a shift from judicial enforcement to more administrative law enforcement (Cafaggi and Micklitz 2009).

H

Harmonization of Law Enforcement

The above-described process of Europeanizing law enforcement in the Member States through the harmonization of national procedural rules has been driven by the EU Commission. However, EU harmonization of civil or administrative procedures faces problems of legitimacy (e.g., private enforcement of competition law in fact is a question of national private law rules, contract, tort, and corresponding civil procedural rules. Case C-453/99 Courage v. Crehan ECR [2001] I-6297) because the Commission lacks the competence and a clear legal basis to harmonize procedural rules. In accordance with the so-called national procedural autonomy and the principle of subsidiarity, the Member States have the competence to lay down private law consequences of EU law infringements as well as the administrative procedures. The Member States provide for remedies to effectuate damage actions, and it is for the national courts to hear cases. (The CJEU has consistently held that

> [I]n the absence of Community rules governing the matter, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive directly from Community law, provided that such rules are not less favourable than those governing similar domestic

> actions (principle of equivalence) and that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness)

Joined cases C-295/04 to C-298/04 *Manfredi v Lloyd Adriatico Assicurazioni SpA and Others* [2006] ECR para 62; Case *33/76, Rewe-Zentralfinanz eG and Rewe-Zentral AG* v *Landwirtschaftskammer fur das Saarland (Rewe I)*, [1976] ECR 1989, para 5, Case C-261/95 *Palmisani* [1997] ECR I-4025, para 27, Case C-453/99 *Courage and Crehan*, par. 29.)

In accordance with Article 5 TEU, the Union is only empowered to act within the competences conferred upon it by the Treaty. With regard to the harmonization of procedural rules, one could turn to Article 114 TFEU, which forms the legal basis for harmonization measures when such measures have as their objective the establishment and the functioning of the internal market. For example, the Public Procurement Remedies Directives were issued on this legal basis. (Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations, and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts [1989] OJ L 395/33; Council Directive 92/13/EEC of 25 February 1992 coordinating the laws, regulations, and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport, and telecommunications sectors [1992] OJ L 76/14.) However, this Article has been strictly interpreted by the EU courts, and it can be applied only when it can be proved that without the harmonization measures, the functioning of the internal market would be endangered and competition distorted. The CJEU, among others, said that the goal of the Commissions' intervention has to be precisely stated by explaining the actual problems consumers face in the internal market and the actual obstacles to the free movement principles as well as the distortions of competition. In *Germany v. Parliament and Council*, the ECJ has explicitly said that

> a measure adopted on the basis of Article 100a of the Treaty must genuinely have as its object the improvement of the conditions for the establishment and functioning of the internal market. If a mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms or of distortions of competition liable to result there from were sufficient to justify the choice of Article 100a as a legal basis, judicial review of compliance with the proper legal basis might be rendered nugatory. (Case C-376/98 Germany v. Parliament and Council [5 October 2000] ECR-I-8419, para 84; Two years later in the 'Tobacco Labelling' judgment when applying the same arguments it approved the adoption of the Tobacco Labelling Directive on the basis of Article 95 EC and it thereby reaffirmed its interpretation of Article 95 as a legal basis for measures of harmonization. Case C-491/01 British American Tobacco v The Queen [2002] ECR I-; Directive 2001/37 on Tobacco Labelling OJ 2001 L194/26 paras 60–61)

Accordingly, the Commission has to precisely define the legal problems by providing clear evidence of their nature and magnitude, explaining why they have arisen and identifying the incentives of affected entities and their consequent behavior.

Since the Amsterdam Treaty Article 81 TFEU can be applied as the legal basis for harmonization of civil procedural law, this legal basis can be used with regard to civil matters which have cross-border implications and in so far as common rules are necessary for the functioning of the internal market. It could be argued that even though this legal basis concerns civil procedural measures, it could be applicable also to administrative procedural law (Eliantonio 2009, p. 4).

Both Article 114 and 81 TFEU require a justification for procedural harmonization measures by showing that the functioning of the internal market is at stake, namely, that the direct effect of substantive EU law might be at risk and market competition would not take place on equal terms, unless at least some minimal requirements concerning procedure were upheld in all Member States, then there would be adequate grounds to support the introduction of harmonized remedies in national courts. Accordingly, in order to decide upon the necessity of EU harmonization measures in the field of procedural law, the negative effects of diverging judicial remedies for European integration should be estimated.

Procedural differences in the Member States could be justified by their impact on business

actors. Competition would be distorted when business actors have to reduce their business in a certain Member State because of the difficulty that they might encounter in enforcing EU law. Consequently, the benefits of harmonized procedural rules may be transparency and legal certainty which might be appreciated especially from the perspective of economic policy and competition.

It is the next section that will discuss these economic arguments of harmonization and legal diversity.

The Economics of Harmonization

As mentioned above, in EU law, the harmonization process is governed by the principles of subsidiarity and proportionality. These principles have been argued to entail a cost-benefit analysis of legislation and require to minimize transaction costs (Van den Bergh 1994). The economics of harmonization discusses the costs and benefits of legal diversity and harmonization. It addresses the optimal level of intervention by applying the economic theory of federalism as extended to the theory of regulatory competition.

The idea that decentralized decision making may contribute to efficient policy choices in markets for legislation was first formulated by Tiebout in his seminal article on the optimal provision of local public goods (Tiebout 1956). (This economic theory argues that local authorities have an information advantage over central authorities, and, therefore, they are better placed to adjust the provision of public goods to the preferences of citizens. Under certain strict conditions, the diffusion of powers between local and central levels of government favor a bottom-up subsidiarity. The economics of federalism deals with the allocation of functions between different levels of government. Tiebout argued that buyers "vote with their feet" by choosing the jurisdiction which offers the best set of laws that satisfy their preferences. The economics of federalism rests upon a number of assumptions. When the "Tiebout conditions" are fulfilled, competition between legal orders will lead to efficient outcomes. There has to be a sufficiently large number of jurisdictions among which consumers and firms can choose. Consumers and firms enjoy full mobility among jurisdictions at no costs. Last, there are no information asymmetries, which on the one hand means that states have full information as to the preferences of firms and citizens, and on the other, suppliers of production factors must have complete information on the costs and benefits of alternative legal arrangements. Only in the presence of these information requirements will consumers and firms be able to choose the set of laws, which maximizes their utility or profit. Further, no external effects should exist between states and regions. There must be no significant scale economies or transaction savings that require larger jurisdictions.) Tiebout's model has been extended to legal rules and institutions. The theory of regulatory competition applies the dynamic view of competition to sellers of laws and choice between legal orders offering a number of criteria to judge whether centralization or decentralization is more successful in achieving the objectives of the proposed legislation (Van den Bergh 1994, 1996, 2002). In this section, these criteria will be applied to the Commission's harmonization proposals in order to consider the likely costs and benefits of top-down rule-making.

One reason to harmonize procedural rules is that these rules differ across countries that they may lead to adverse externalities for other Member States. Such negative spillover effects might be present with regard to different procedures as well. While such negative externalities can be internalized by harmonization, bargaining between the Member States can also solve this problem. According to the Coase theorem, when property rights are well specified, transaction costs are low and information is complete and bargaining can be an efficient solution (Van den Bergh and Camesasca 2001, p. 132).

Another reason in favor of harmonization is that different legal rules carry the risk of destructive competition. Such a "race to the bottom" development has often been linked and criticized as a result of competition among jurisdictions. It has been argued that competition among legal rules drives social, environmental, cultural, and other standards down. This argument has been

mainly embraced in international corporate law by making reference to the "Delaware effect." However, the risk of such declining levels of standards has not yet been proved, and the little empirical evidence is not conclusive enough (Wagner 2005; Josselin and Marciano 2004, pp. 477–520; McCahery and Vermeulen 2005). Furthermore, international trade may even stimulate race to the top (Van den Bergh and Camesasca 2001, pp. 153–154). Gomez also argues that the outcome of such competitive process cannot be examined without taking into account the relative power of the affected groups (Gomez 2008). Such competition might not harm powerful and well-organized groups but could have different effects for small- and medium-sized enterprises and consumers.

A third argument often raised to support harmonization is to achieve scale economies and to reduce transaction costs. Transaction costs can be high when firms and consumers have to search and comply with different sets of national rules. In the case of uniform rules, the search costs of information could be saved, and complying with one set of rules can achieve scale economies. Uniform rules can guarantee more stable and predictable jurisprudence and considerably contribute to transparency and legal certainty.

In particular, it has been argued that business would profit from clear and transparent system in which they would be able to enforce their claims against public authorities all over Europe pursuant to the same procedural rules (Eliantonio 2009, p. 6). This raised the question whether procedural harmonization may be pursued in a "compartmentalized" way for specific policy areas. With regard to the private enforcement of EU competition law, two remarkable suggestions were made. Both concern a separate harmonization of economic torts or in the present case economic administrative procedures. Heinemann proposed that general tort rules of the DCFR could be examined against the backdrop of the special needs of competition law (Möllers and Heinemann 2007, p. 377). Boom proposed a compartmentalized approach to work with the existing modest body of European tort law. By addressing the policy issues involved in each of these torts one by one, the European Union can make harmonized tort law more attainable. He pointed out that a likely candidate for harmonization is the category of economic torts, such as the protection of intellectual property through tort law, liability for infringement of competition rules, and the liability for misleading advertising (Van Boom 2008, pp. 133–149).

However, transaction costs can be especially relevant for large firms operating in interstate commerce, the same might not hold for small- and medium-sized undertakings operating mainly in national markets or for consumers. Therefore, as mentioned above, the impact of such harmonization also has to be analyzed with having regard to the relative power of the affected groups.

Furthermore, while uniform rules help to maintain economies of scale, which is an important argument for centralization, but they can only be advantageous from an ex ante perspective, when neither the Member States nor the Community have as yet adopted certain legislation (Van den Bergh 1998). This is neither the case with regard to administrative or civil procedural rules, which are rooted in old legal traditions and characteristics of the different legal systems.

When all parties in one region have identical preferences, cost efficiency considerations might point to harmonizing through one single instrument that suits all. This is clearly in-line with the preferences of the business community as they are in favor of uniform rules. However, the preferences of consumers and public administration can significantly diverge. In fact, it has been argued that the legal systems of the Member States are built through habits, customs, and practices which dictate how law is going to be interpreted (Legrand 2002, p. 230), and that public law "has particularly deep roots inside a cultural and political framework" (Harlow 2002, p. 208). This is clearly the case with regard to enforcement bodies as these are a wide variety of institutions that enforce EU law in the Member States (Cseres 2013; Balogh and Cseres 2013).

Accordingly, the possibility of achieving a common procedural (administrative or civil) law in Europe is doubtful because the political conditions are missing and because the national legal

systems are based on very different conceptions (Eliantonio 2009, p. 8). The same is true for bridging the gaps between the various economic policies and institutional settings. Harmonization of administrative procedures might conflict with legitimate national interests, such as the need to protect fairness and efficiency in the administration of justice (Eliantonio 2009, p. 7). Due to these fundamental differences in national administrative procedures, it would be very difficult to agree on common rules for all 27 jurisdictions, and in fact, it has been argued that "a general codification could be achieved only by reducing the requirements to the level of a common denominator, in which case it would prove as a barrier rather than an asset for an effective and uniform enforcement of Community law" (Schwarze 1996, p. 832). Moreover, some Member States may prefer to implement criminal law procedures for the enforcement of most severe law violations as this is the case already in a significant number of Member States concerning consumer, environmental, or even competition law.

In sum, there are not sufficient economic arguments in favor of harmonization, but there are good economic arguments in supporting legal diversity. One such argument is that a larger set of legislations can satisfy a wider range of preferences which leads to allocative efficiency. The broad range of preferences can easily be seen behind the various different regulations on unilateral conduct, but it also holds for administrative procedures. Another argument is information asymmetries that support decentralization by maintaining the principle of subsidiarity and procedural autonomy. When information at local level is more valuable for rule-making and law enforcement, decentralization is more efficient. Competition between these legal rules has the advantages of a learning process. National laboratories produce different rules that allow for different experiences and that can improve the understanding of alternative legal solutions. (Justice Brandeis' famous metaphor for states as laboratories of law reform and his plea for decentralization has been laid down in his dissenting opinion in *New State ice Corp. v. Liebmann, 285 US 262, 311* (1932).)These advantages are relevant for both the formulation of substantive rules as well as law enforcement. Moreover, legal diversity and competition does not necessarily exclude harmonization. In fact, dynamic competition between legal rules can lead to voluntary harmonization which in turn can be more effective and successful than forced coordination of legislations. Instead of forced harmonization, the Commission could guarantee the conditions for regulatory competition and let this process work up to voluntary harmonization. These conditions could in fact be ensured within the various European networks of national regulatory agencies that were set up in the last decade.

H

Voluntary Harmonization

This section will analyze the underlying rationales of voluntary convergence by making use of insights from comparative law and economics.

Comparative law and economics compares and evaluates the law of alternative legal systems with the "efficient" model offered by economic theory (Mattei et al. 2000, pp. 506–507) (Mattei 1994). Comparative law and economics deals with "legal transplants" by measuring them with the tool of efficiency, and it offers an economic analysis of institutional alternatives tested in legal history (Komesar 1994). It "deals with the transplants that have been made, why and how they were made, and the lessons to be learned from this." While it offers comparative lawyers the measuring tools of economics, it, at the same time, places the notion of efficiency in a dynamic perspective by offering a comparative dimension with concrete alternative rules and institutions (Watson 1978).

The insights of comparative law and economics offer a dynamic approach to study legal divergence and convergence and compare that against the benchmark of efficiency offered by economics. In order to explain convergence between different legal systems that depart from different points, it uses economic efficiency to evaluate changes that are so-called legal transplants in a legal system. Convergence between different legal rules toward an efficient model may take

place as a result of a legal transplant or as an outcome of a competitive process between different legal formants (Mattei et al. 2000, pp. 508–511). In the first case, legal transplants are implemented because they proved to be efficient in other legal systems. In the second case, convergence toward efficiency is the result of the interaction between different legal formants. So while legal transplants are governed by hierarchy, the second scenario is governed by competition among legal formants (Mattei et al. 2000, pp. 510–511).

In EU competition law, for example, the Member States voluntarily harmonized various elements of their national administrative procedures (European Competition Network 2013). Yet, this convergence exhibits some shortcomings in terms of the benchmark it uses and in terms of the methods to achieve convergence. First, convergence between the different national rules uses Regulation 1/2003 and some accompanying soft-law instruments as its benchmark. Thus, convergence so far took place through legal transplants imposed by the Member States and by in fact implementing similar procedural rules as those of the Commission's. The underlying reasons might be that once these rules and enforcement methods work effectively and efficiently in the hands of the Commission, they will prove successful in the hands of the NCAs as well. However, the efficiency of these rules and their comparative advantage vis-à-vis other national rules has neither been analyzed nor confirmed. Furthermore, the success of such legal transplants is not guaranteed in the different institutional frameworks of the Member States, where agencies often have to divide resources between several legislative competences. The actual outcome of enforcement depends heavily on the existing institutional framework (Cseres 2014a, b).

The influence of the institutional framework also plays a role in measuring actual law enforcement and in understanding why a certain legal rule proves to be successful or fails in different institutional contexts (Stiglitz 2002; North 1995, p. 13).

Despite the blueprint convergence of procedural rules, the NCAs could not or did not actually enforce these rules due to certain constraints present in their institutional framework. The strengthened enforcement tools have not always delivered the expected results in actual enforcement. This is, for example, the case with regard to the power to investigate private premises (Commission Staff Working Paper, par. 202.). Similar experience has been found with regard to leniency programs which are often praised as the model for procedural convergence in EU competition law and a clear result of the cooperation mechanism within the European Competition Network (Cseres 2014a, b).

Convergence of national laws in EU competition law is also steered from the center by the Commission establishing the EU rules as the benchmark for harmonization (Cseres 2014a, b). While the Commission was seemingly decentralizing enforcement powers, in fact it has retained a central policy-making role but without a control mechanism.

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Hate Groups and Hate Crime

Matt E. Ryan[1] and Peter T. Leeson[2]
[1]Department of Economics, Duquesne University, Pittsburgh, PA, USA
[2]Department of Economics, George Mason University, Fairfax, VA, USA

Definition

Hate crimes are criminal offenses motivated by offenders' animus toward their victims based on victims' race, religion, sexual orientation, or other such characteristic. Hate groups are organizations of individuals whose organizing purpose is thought to reflect animus toward certain people based on their race, religion, sexual orientation, or other such characteristic.

The Economics of (Hate) Crime

Gary Becker (1968) pioneered the economics of crime by applying rational choice theory to analyze decisions to break the law. In his rendering, and in most of the enormous literature in the economics of crime following Becker, criminal activity is motivated by the prospect of material gain.

Although material gain undoubtedly motivates the vast majority of criminal behavior, it does not motivate all of it. One example of criminal behavior not so motivated is that which reflects "hate crime." The Federal Bureau of Investigation defines such crime as "criminal offense against a person or property motivated in whole or in part by an offender's bias against race, religion, disability, sexual orientation, ethnicity, gender, or gender identity." A Neo-Nazi who vandalizes a Jewish synagogue because of his animus toward Jews, for example, commits a hate crime. As Gale et al. (2002) point out, hate crimes thus differ from most other crimes in that the perpetrator's goal is not (at least in whole) to make himself better off, but rather to make his victim worse off.

Correlates of Hate Crime

The correlates of hate crime include at least two factors commonly found to be important determinants of crime more generally: unemployment and income. Medoff (1999), Gale et al. (2002), Ryan and Leeson (2011), and Curthoys (2013), for example, find a positive relationship between unemployment and the incidence of hate crime in the United States (though Green et al. 1998 and Mulholland 2013 find no consistently significant relationship). Similarly, Sharma (2015) finds that underemployment is a significant determinant of cross-caste crime in India, and Iparraguirre (2014) finds that "employment deprivation" is associated with more hate crime against older people in England and Wales. Medoff (1999) finds a negative relationship between wages and hate-crime incidence. And Gale et al. (2002) and Sharma (2015) find a positive relationship between the ratio of income of a targeted group to the

(presumed) targeting group and race-based and cross-caste crime, respectively.

A correlate of hate crime that may be more specific to this particular type of offense is the social perceptions of persons who are typically victims of hate crime. Hanes and Machin (2014), for example, find that the terrorist attacks of September 11, 2001 in the United States and on July 7, 2005 in London were associated with increased hate crimes against the Asian and Arab populations in England.

Do Hate Groups Matter?

The Southern Poverty Law Center (SPLC) defines hate groups as groups which "have beliefs or practices that attack or malign an entire class of people, typically for their immutable characteristics." Among such groups, the SPLC counts the Ku Klux Klan, Neo-Nazi, White Nationalist, Racist Skinhead, Christian Identity, Neo-Confederate, Black Separatist, and "General Hate" groups. To a certain extent, a particular group's status as a "hate group" may be a matter of debate. The SPLC, for example, considers "patriot groups" hate groups; however, it is questionable whether all such groups can be reasonably likened to the Ku Klux Klan, Neo-Nazis, or other such groups whose organizing purpose is clearly grounded in racial, religious, or some other such prejudice.

Since hate groups are those that malign (or are thought to malign) people based on their race, religion, sexual orientation, etc., an obvious question is whether the prevalence of such groups is an important determinant of criminal offenses committed against such people – hate crimes. Theoretically, the answer to this question is ambiguous. If an important activity of hate groups is the perpetration of crimes against hated classes, one would expect more hate groups to lead to more hate crime. Alternatively, hate groups may act as substitutes for, rather than complements to, hate crime. For example, if hate groups serve predominantly as outlets for individuals to congregate and "safely" vent their hatred of certain persons, which might otherwise manifest in the form of criminal acts against these persons, such groups may displace hate crime with the hateful bluster. In this case, it is possible that more hate groups could lead to less hate crime.

Empirical examination of the relationship between hate groups and hate crime in the United States has delivered somewhat mixed results. Ryan and Leeson (2011), who consider the relationship between the number of hate groups and hate crime at the state level between 2002 and 2008, find no evidence that more hate groups lead to more hate crime. Mulholland (2013), who uses county level data between 1997 and 2007, finds that an active white supremacist group within a county is associated with an increased rate of hate crime in that county. Adamczyk et al. (2014), who also use county level data from 1990 to 2012, find that ideologically motivated homicides are more likely in counties with larger numbers of hate groups. Most recently, Larson and Brandt (2016) consider the number of Ku Klux Klan chapters in 72 combined statistical areas (CSAs) between 2006 and 2014 and find that while CSAs with a larger number of active Ku Klux Klan chapters experienced higher rates of racially motivated crime, they also experienced lower rates of religiously motivated crime.

Cross-References

- ▶ Becker, Gary S.
- ▶ Crime: Expressive Crime and the Law
- ▶ Crime and Punishment (Becker 1968)
- ▶ Criminal Sanctions and Deterrence
- ▶ Economic Analysis of Law

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Hayek, Friedrich August von

Edward Peter Stringham[1,2] and Todd J. Zywicki[3]
[1]Economic Organizations and Innovation, Trinity College, Hartford, CT, USA
[2]American Institute for Economic Research, Great Barrington, MA, USA
[3]Antonin Scalia Law School, George Mason University, Arlington, VA, USA

Abstract

F.A. Hayek focused on many traditional economic questions, and also made important contributions to law and economics. His framework differed from Kaldor Hicks efficiency and the wealth maximization norm common among neoclassical law and economics scholars. But he talked about how the common law evolves and helps shape economic outcomes. Underlying this approach was Hayek's conviction that the essence of law is not created by the state, but rather preexists in the conventions and understandings within a community. Hayek argued that the role of the judge in a common-law system is to discover the law in the imminent consensus of norms and expectations. Hayek's work has many implications for positive analysis and normative discussions of what judges should or should not do. To Hayek, the primary purpose of the law is not a wealth maximization problem, but to provide a stable institutional framework in a dynamic world that enables individuals to plan and coordinate.

Biography

Friedrich A. Hayek was born in Vienna in 1899 and won the economics Nobel Prize in 1974 for "pioneering work in the theory of money and economic fluctuations" and "penetrating analysis of the interdependence of economic, social and institutional phenomena." After studying under Ludwig von Mises in the 1920s, Hayek had a series of debates with John Maynard Keynes about government's ability to manage the business cycle. In the 1930s and 1940s, Hayek joined Mises in a debate against those who argued that government should centrally plan the economy. He maintained that economic problems cannot simply be solved with a system of simultaneous equations. In "The Use of Knowledge in Society," Hayek (1945) interpreted the role of prices in a market society as the most effective means of allowing people to use their knowledge of time and place to develop economic plans consistent with those of the rest of society. And Hayek described the market itself as a "discovery process" for generating that very knowledge. His best-selling work was *The Road To Serfdom,* where Hayek (1944) argued that even setting aside the fatal economic flaws, socialism and milder forms of government planning are incompatible with freedom in the long run. Much of this work amounts to a vindication of the notion of spontaneous order – patterns that emerge through human action but not human design. Hayek came to see that the notion applied just as well to the formation of law, thereby making an early contribution to the field of land economics. (This entry focuses on Hayek's contribution to law and economics. For a more comprehensive discussion of Hayek's thought, see Caldwell (2004).)

Innovative and Original Aspects

In the earlier part of his career, Hayek followed the Continental *Rechstaat* tradition – going back to Napoleon – where law is understood as statute-based, formally expressed rules. Hayek believed these rules should be forward-looking, well-articulated, and applied equally to all individuals. Such thought can be found in his *The Road to Serfdom* (1944) and *The Constitution of Liberty* (1960).

But Hayek came to shift his views radically, as can be seen in his three-volume series *Law, Legislation, and Liberty* (1973; 1976; 1979). Hayek underplayed the significance of the shift, viewing it as a move from a focus on "public" law to "private" law. Empirically, Hayek had now turned his attention to the common law of England from the Continental law. Analytically, and viewed from the outside, Hayek began breaking from the prevailing scholarly understanding of the ideal of law – and of law itself.

According to the later works of Hayek, not only was the common law a spontaneous order, the common law was analogous to the market process. Properly instituted, common law evolved according to the population's changing expectations concerning disputes. In contrast, top-down civil law evolved based on legislators' understanding of what rules best resolve disputes. Legislators attempt to institute detailed rules to anticipate all future legal circumstances. In common law, judges instead act on the facts of particular cases, but the unintended result of all such decisions is a body of law that not only coordinates most people's expectations, but makes use of detailed, tacit, and local knowledge and promotes liberty. Another effect of the decentralized legal process is that abstract, coherent principles emerge. "In an ever changing society," Hayek wrote, "judges must seek to find rules that will aim at securing certain abstract characteristics of the overall order of our society that we would like it to possess to a higher degree" (Hayek 1973, p.105).

The common law is not only abstract, but non-arbitrary, despite emerging without central design, as it aggregates knowledge implicit in the pre-existing, commonly understood conventions of people in particular communities (Hume 1740, Book III, p.541; Hayek 1973, p. 162). To be sure, certain conventions needed for a society to thrive can be objectively identified: stability of ownership (property law), transference by consent (contract law), and protection of property (tort law). Such a perspective can be consistent with a natural law- or rights-based perspective where certain basic rights or side constraints, to use Robert Nozick's language, exist. But within that basic framework, many of the specifics of legal procedures and law itself can be seen as evolving. Under the right conditions, a Darwinian process of competition among communities with differing bodies of law tends to lead law to converge away from systems that fail to protect investment and resource conflict toward systems that lead to peaceful cooperation (Zywicki 2000).

Hayek found further merit in common-law systems for making law predictable. Counter-intuitively, civil law, despite its greater verbal precision, provides less predictability. Common law works in this respect because people in any given community have an intuitive understanding of the rules reflecting their widely shared sense of what is just. Having this understanding, potential litigants can predict on their own how cases would be decided and can adjust their planning accordingly. They may not be able to articulate the rules (their knowledge of the law is tacit; Zywicki 1998), but regardless, their intuitive understanding means they often need not consult case law. In contrast, potential litigants in a civil-law system must often seek legal advice to learn the specifics of complicated rules.

Given that the rules constituting common law are difficult for litigants to articulate, it should be no surprise that the role of the judge is to discover conventions, not construct them. Such a judge considers the implicit consensus of norms and expectations in a given community and applies it to the facts in particular cases (Zywicki and Sanders 2008). A legislator, in contrast, considers what external standard should govern disputes. The body of judge-discovered law emerges spontaneously (Hayek 1973, p.118); the civil law arises by design. Hayek (1973, p.123) wrote,

"The difference between the rules of just conduct which emerge from the judicial process, the nomos or law of liberty—and the rules laid down by authority . . . lies in the fact that the former are derived from the conditions of a spontaneous order which man has not made, while the latter serve the deliberate building of an organization serving specific purposes." Put differently, common law "has never been 'invented' nor can it be 'promulgated' or 'announced' before hand" (1973, pp. 72, 118).

Hayek considers the common law's discovery process as analogous to that of price discovery in markets (Zywicki and Sanders, 2008). The owner of a gas station, for example, must discover and articulate what price the consumer will pay for gasoline, based on the supply and demand resulting from the outcome of billions of individuals' interactions. Similarly, a judge discovers and articulates the preexisting rules. Both the gas station owner and the judge engage in a process of trial and error.

Discovery of the law involves a search for what conventions govern the particular circumstances of time and place. The specific conventions evolve over time and differ across place because individuals' needs for exploiting their local knowledge differ. But though the conventions differ, they reflect the underlying, universal, and nonarbitrary principles for resolving disputes and promoting coordination. As society becomes more complex, larger, and more heterogeneous, the need arises for someone to articulate the conventions. But the law itself is the consensus of principles and expectations, not the judges' articulation of the consensus.

Beyond the advantage of allowing judges to discover legal rules, the decentralized process of law making ensures there is no central decision-maker for interested parties to capture who can then impose a rule that will generate long-term rents, thereby reducing the opportunity and incentive for rent-seeking litigation.

Despite all of the perceived advantages of the common law, Hayek ultimately saw room for legislatures to step in when common law reaches a "dead end." The judge's proper role is at most to articulate new rules within an existing framework of rules and expectations – not to alter expectations and amend the framework. To Hayek, the legislature's proper role is to devise new rules when existing rules have become obsolete or if rules inconsistent with a market economy emerge. In his ideal, the legislature should act consistently with the purpose-independent, abstract principles of the common law (*cosmos*) rather than transform it through command-oriented rules (*nomos*). So even though Hayek supported judges setting most precedents, he supported legislatures overseeing the process to remove bad precedents.

One could argue that a tension exists in Hayek's thinking here. On one hand, Hayek saw the evolution of law as a discovery process akin to the market's discovery process. But at the same time, he analogized the monopolistic court system to the market system. But given that markets are disciplined by profits and losses, can a monopolistic court system have similar discipline? Can such a system learn whether the rules are consistent with underlying principles and expectations without the aid of competition? Does his other analysis about markets as a discovery process logically imply that an effective legal system must require competition as well (Stringham and Zywicki 2011a, b)?

Impact and Legacy

Hayek's work has many implications for positive analysis and normative discussions of what judges, or other government officials such as regulators, should or should not do. In a Posnerian normative framework, judges should evaluate the costs and benefits of different decisions or laws in general and implement those that maximize wealth. But a Hayekian framework stresses the knowledge problems that confront judges seeking to determine and implement the wealth maximizing decision or set of rules. A Hayekian framework also emphasizes the subjective nature of individual cost and choice and the challenges this provides for any judge seeking to ascertain the efficient rule in any scenario. In this sense, judges seeking to maximize societal wealth or Kaldor Hicks efficiency are in a similar position to any central planner seeking to allocate resources to optimize wealth. They lack the necessary information to weigh costs and benefits and choose what is best for society. Such logic also applies

to judges who wish to tweak the details of the law. For instance, a movement from contributory to comparative negligence may have implications not only for other elements of the tort system (such as liability rules or damages), but also contract law, procedure, and remedies.

The more neoclassical law and economics models also implicitly assume that the world is in equilibrium where the judge simply compares the end states of his possible decisions. A Hayekian influenced law and economics, in contrast, recognizes that the world is in a state of change as billions of consumers around the world seek to constantly adjust to millions of constant and simultaneous shocks. Such change affects basic economic conditions but can also disrupt contractual relationships and lead to conflict among individuals (Zywicki and Sanders 2008). In Hayek's perspective, equilibrium cannot describe the world in the abstract. Instead we should focus on the ability of individuals to mesh their plans at any given time and to form expectations about how parties will perform in the future.

In this view, the primary purpose of the law is not a wealth maximization problem, but instead to provide a stable institutional framework that enable individuals to plan and coordinate their affairs in a world of constant dynamism. A set of relatively stable and clear rules enable people to predict one another's behavior (Hayek, 1978). Relatively clear and stable rules create boundaries for property rights, and other legal obligations enable individuals to adapt their behavior to the ever-changing world that surrounds them. Adding a constantly changing legal system – even if in the name of "modernization" or "updating" – to this chaotic world could create uncertainty and undermine the ability of individuals to coordinate their plans in the face of constant need for adaptation.

Zywicki (1998) argues that getting rid of letting government constantly change or adjust the law actually allows ordinary people to have a greater degree of confidence in the content of the law without needing to consult lawyers or run across an unexpected legal obligation. It also enables radical decentralization of decision-making authority to individuals who have the tacit and local knowledge most relevant to the particular decision. Some law and economics scholars influenced by Hayek focus on legal norms or even entire legal systems that clearly emerged without central design or even any government control. Bernstein (1992) and Ellickson (1991) show that New York diamond merchants and California farmers and cattle ranchers devise various rules and regulations to govern their behavior independent of what legislatures or government judges say. Benson (1990) argues that the entire law merchant was created by business people to meet their needs of exchange. Stringham (2015) highlights that in seventeenth century Amsterdam, eighteenth century London, and nineteenth century New York, complex financial contracts emerged even though government was not enforcing, or actively trying to prohibit, them. The rules that govern the most advanced markets in the world market emerged from the market. In a Hayekian law and economics perspective, the world is not an optimization problem that government planners, regulators, or judges evaluate and solve. Instead the world, including law itself, can be viewed as a spontaneous order.

Cross-References

- ▶ Austrian Perspectives in Law and Economics
- ▶ Constructivism, Cultural Evolution, and Spontaneous Order
- ▶ Harmonization of Tort Law in Europe
- ▶ Law and Economics
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Hedge Fund Activism in Corporate Governance

Alessio M. Pacces
Erasmus School of Law, Rotterdam Institute of Law and Economics, Erasmus University Rotterdam, Rotterdam, The Netherlands

Definition

Hedge fund activism is an important disciplinary mechanism in corporate governance. It consists in actions aimed to change the way a company is managed, without trying to gain control. Because hedge funds aim to profit from these actions, this is called entrepreneurial shareholder activism.

A hedge fund campaign can only succeed if a majority of institutional shareholders supports it. The question whether hedge fund activism leads to inefficient short termism in corporate governance can only be answered by looking at which investors are decisive on such campaigns. Although the empirical evidence on this is still unclear, index funds seem to be decisive in most instances.

Because of their incentives, index fund managers cannot be trusted to make an informed decision about whether the company should be managed for the short term or the long term. It turns out that the optimal choice in this respect varies with the individual companies and with time. As a result, companies should be enabled to opt out of hedge fund activism by way of dual-class or at least loyalty shares, if a majority of institutional investors agrees to this solution ex-ante.

Introduction

Some ten years ago, a prominent law and economics commentator defined hedge funds (and private equity funds) "the newest big thing in corporate governance" (Macey 2008: 241). Activist hedge funds are definitely the big thing in corporate governance today. They intervene in corporate governance with the goal to make changes happen. So do private equity funds, but there are two differences. For one, hedge funds are supposed to unlock existing value, whereas private equity purports to create new value. Secondly, hedge funds confront the management of public companies, whereas private equity makes friendly deal with them to take the company private. This entry focuses on hedge fund activism as a disciplinary mechanism in the governance of public companies.

Although hedge fund activism has emerged as an US phenomenon, it has now become international (Becht et al. 2016). Hedge fund activism is increasingly prominent in Europe, for instance, in the UK. Moreover, hedge funds are active in

concentrated ownership structures, too. Somewhat surprisingly, activist hedge funds have succeeded in extracting concessions also in the presence of dominant shareholders. Importantly, hedge funds do not always achieve outcomes from engaging the management and do not need to engage overtly in order to achieve outcomes.

Activist hedge funds screen the market for underperforming companies and buy a significant stake in them in order to engage their management. The goal of activists is to make a profit from improving the company's performance, which will be reflected by an increase in the value of their stake when it is sold back to the market. In doing so, hedge funds are coping with the fundamental agency problem stemming from separation of ownership and control, namely, the failure by management to maximize shareholder value. However, because hedge funds profit from a short-term change in the stock price of the target company, they may also be responsible for short termism in corporate governance. Feeling the pressure of hedge funds, managers may pursue short-term stock returns at the expenses of long-term value creation. For this reason, hedge fund activism is highly controversial.

From a law and economics standpoint, the question is whether hedge fund activism remedies or exacerbates market failure. On the one hand, the reduction of agency costs stemming from activism improves the efficiency of corporate governance. On the other hand, if the profitability of hedge funds activism depends on short-term pricing, the ability of corporate governance to sustain certain long-term projects may be undermined. To answer these questions, it is crucial to understand what drives hedge fund activism as well as the factors affecting its success.

Hedge Fund Business Model

Shareholder activism is not new. Activists, such as individuals or public pension funds, have always been prompting managers to act on some issue, sometimes for ideological reasons. Before the advent of hedge funds, however, such activism has not been very effective in achieving outcomes of sort, let alone in affecting stock prices (Bratton and Mc Cahery 2015).

Hedge fund activism is different. Like other activists, hedge funds take actions aimed to change the way a public company is managed, without trying to gain control (Gillan and Starks 2007). However, differently from traditional activism, hedge funds strive to profit from the changes they provoke. This is called "entrepreneurial activism" (Klein and Zur 2009). The changes can be quite radical, such as the departure of the CEO or some other executives, if not the restructuring of the company. Likewise, activist hedge funds may seek to stop a change wanted by the management, for instance an acquisition.

The mark of entrepreneurial activism's success is whether the desired change happens or not. Hedge funds have a different business model than other institutional investors. Hedge fund managers charge a performance fee in addition to a percentage of the asset under management. The remuneration usually follows the so-called 2-20 rule: 2% of the asset under management plus 20% of any increase in the value of the portfolio. This remuneration structure aligns the hedge fund incentives with investors having a relatively high appetite for risk. Hedge funds profit from investing in stock that they can buy, hold, and resell at a higher price.

Two factors are key for the success of entrepreneurial activism. First, the hedge fund needs to be able to buy the bulk of its stake in the company, while the stock market does not anticipate the engagement. The moment the engagement is revealed, investors will anticipate gains, and discounting those for the probability that the engagement fails, the stock price will rise disabling further profit from activism. Second, the activist needs to be able to persuade the management to implement the desired changes. To increase its leverage with the management, the activist can use several techniques, ranging from news campaigns to threatening a lawsuit. The last resort, however, is a shareholder vote. Reached that point, the success of the engagement will depend on whether the activist has managed to attract sufficient support from other shareholders to get a favorable vote. This explains the

importance of proxy contests for activism in the USA and of the rules for initiating and executing a shareholder vote in the European jurisdictions.

The support by institutional investors is crucial for successful engagement. The typical hedge fund stake in the target company is slightly above 6%, which is not nearly a controlling one. As a result, activists must persuade other investors to vote for them. Similarly, engagement may succeed based on the sheer threat of winning a contested vote. From the moment the hedge funds formulate their demands to the management, both parties start to speak with the largest institutional investors, while the investing public is in the dark about the engagement. Management will give in to the activists' demands when it is clear they are going to lose the vote, whereas hedge funds will withdraw from engagement when they realize that not enough institutional investors will vote for them. The fight becomes public only when the outcome is ambiguous. Consequently, a substantial portion of hedge fund engagement takes place behind closed door. This is consistent with the theoretical literature on litigation vs. settlement, as noted by Bebchuk et al. (2017a).

As explained by Gilson and Gordon (2013), the tremendous influence activists have gained in corporate governance depends on the reconcentration of ownership occurred in the past few decades. The bulk of equity investment is no longer in the hands of dispersed individual stockholders, but is managed by institutional investors. In 2016, institutional investors collectively held 63% of US public equities. Institutional ownership is also concentrated. The largest five and 20 institutional investors control, respectively, above 20% and 30% (on average) of the voting rights in the 20 largest US public companies (Bebchuk et al. 2017b). This is very important for activists, who need to be able to speak rapidly with the people casting a majority of the votes. The situation is similar in Europe. A recent OECD study reveals that institutional investors own nearly 90% of UK listed equities (Isaksson and Celik 2013). Although the style of engagement differs considerably across countries, hedge funds activism consistently gets traction wherever institutional ownership is concentrated.

Although institutional investors are crucial for the success of hedge fund activism, they do not act as activist themselves. The reason is agency costs. Institutional investors are prohibited from charging performance fees. Instead, they charge fees as a proportion of the assets under management, which is for them the key variable to maximize. Differently from hedge funds, institutional investors care about relative, not absolute performance. Asset managers do not have incentives to monitor individual companies because competitors will free ride on their efforts. Therefore, the activists' teaming up with institutional investors seems to be beneficial for corporate governance. On the one hand, activists lower the agency costs of institutional ownership. On the other hand, institutional investors screen the activists' proposals and should sanction only the value-increasing ones.

Reducing agency costs undoubtedly improves the efficiency of corporate governance. However, this does not imply that hedge fund activism is always value increasing. Several objections have been raised concerning the judgment of institutional investors.

Critique of Hedge Fund Activism

A first point of criticism is that institutional investors may fail to exercise judgment in the presence of hedge fund engagement. Rather, they would blindly follow the recommendations of proxy advisors, notably including global market leaders such as Institutional Shareholders Services (ISS) and Glass-Lewis, to decide whether to vote for or against hedge funds. The incentives of proxy advisors to get corporate governance right are even more questionable than those of institutional investors, if only because advisors do not have stakes in the companies for which they recommend a vote. Nevertheless, US legislation has effectively encouraged institutional investors to purchase proxy advisory services to meet the obligation to disclose their voting and avoid embarrassment (Rock 2015). The European Union is now following suit (Pacces 2017).

Empirical research suggests that the impact of proxy advisors on the voting by institutional

investors may be not as decisive as it looks. To begin with, only the smaller institutional investors systematically follow the proxy advisors. Large asset managers, such as Blackrock, Vanguard, or State Street, seem to vote independently. Moreover, every study of proxy advisors' impact faces a fundamental reverse causality problem. In the end, although there are clear synergies in judgment (McCahery et al. 2016), it is impossible to determine how much proxy advisors influence large institutional investors and how much they are influenced by them. Although there are no specific studies on the impact of proxy advisors on hedge funds activism, a US study of uncontested elections reveals that ISS advice against the management shifts at most 10% of votes.

Another fundamental critique levered at hedge funds is that they may succeed without any screening by institutional investors, if they act as a coalition, namely as a so-called "wolf pack." Empirically, wolf packs account for about 22% of the engagements observed internationally and are associated with a higher success rate than individual engagements – 78% as opposed to 46% (Becht et al. 2016). On this basis, Coffee and Palia (2016) have argued that wolf packs are a nearly riskless strategy for hedge funds, suggesting that this may lead to over-engagement. However, the impact of wolf packs seems to be overestimated. Firstly, in more than one-fifth of observed wolf pack engagements, the engagement has been unsuccessful. Because unsuccessful engagements result in losses, even wolf packs face risks. Second, wolf packs are never large enough to control a majority of the votes, which makes institutional investors still decisive. Finally and most importantly, 78% of the overt engagements mapped internationally are not wolf packs. This cannot be random because hedge funds choose their battles. If they decide to join and form a wolf pack only when success is more likely, the success rate of wolf packs is overestimated.

The recurrent objection to hedge funds activism is short-termism. This critique is more difficult to handle because short-termism means different things to different people. In one respect, this critique is not borne out by the empirical evidence. Both in the USA and internationally, the announcement of hedge fund engagement leads, on average, to a significant increase of the stock price. This increase is not reversed for up until 5 years down the road (Bebchuk et al. 2015), provided that the engagement is effective in determining change (Becht et al. 2016). Therefore, hedge funds are not short-termist in the conventional sense of "cutting and running." While useful to defend hedge fund activism from an easy rhetoric against them, this result says nothing about whether the stock markets is myopic relative to some horizon longer than the activists' holding period (1.7 years on average), let alone whether it makes sense to consider such a longer horizon to assess the performance of any particular company.

Theory and Evidence on Hedge Fund Activism

Underlying the short-termism discussion, there is a fundamental question about the desirability of hedge fund activism. Hedge fund activism is an important feedback mechanism in corporate governance, but its efficiency is not obvious. Assuming that other stakeholders either protect themselves by contract or are protected from externalities by efficient regulation (Pacces 2012), efficient corporate governance requires maximization of shareholder value. If financial markets were informationally efficient, there would be no difference between short-term and long-term maximization of shareholder value because any asymmetry would be arbitraged away. If, however, stock markets overweight the short-term profits of a company relative to its long-term profits, albeit temporarily, there is market failure. This is a problem for corporate governance to the extent that short-termism leads managers to make value-destroying choices. Whether this is actually the case is uncertain, though, as the management may more or less intentionally err towards the long term to justify underperformance (long-termism). Defining short- and long-termism is conceptually difficult

in the absence of a consensus on what constitutes the "right term" to maximize profit.

What is "right" term depends on the "right" strategy to maximize profit; both are difficult to identify. Stock markets are an impressive source of information in this respect, but alas, they are imperfect. Because they overreact to news, misprice risks, and are prone to asset bubbles, stock market prices do temporarily fail to incorporate the value of future profit opportunities. When this is the case, the Efficient Capital Market Hypothesis (ECMH) does not hold true. Therefore, there may be a conflict between the pursuit of short-term results, which are immediately impounded in market prices, and long-term projects, whose expected results are underweighted or even overlooked by stock prices. Because the hedge fund business model is based on stock market prices, pressure from activist hedge funds may well turn the short-termism of stock market into short-termism of managerial choice.

The question whether public companies should be managed for a shorter or a longer term cannot be answered empirically. Data reveal that successful activism, on average, is associated with a stock price increase. However, this result is uninformative because hedge fund activism produces unobservable effects, too, and because the companies for which we observe engagements cannot be meaningfully compared to those that are not engaged.

The first part of the problem is that we only observe a portion of the true activism, the overt part, whereas a great deal of activism takes places behind closed doors. Moreover, the distribution between overt and covert activism is not random. Better-managed companies react in anticipation of hedge fund engagement, whenever this is a credible threat. Activists, on the other hand, may have to make their campaign public precisely when the targeted is more mismanaged, which overestimates the observable returns from engagement.

The second part of the problem is that companies that are or can be targeted by activists fundamentally differ from those that are not and cannot be targeted. The fact that companies successfully engaged outperform a market index, on average, does not really show that activism improves performance. It only shows that target companies were undervalued relative to a market benchmark and that activism brings performance back in line with that benchmark. These studies cannot rule out the possibility that a target company would outperform the benchmark by a larger extent, if not engaged, because this counterfactual company does not exist and, if it existed, it would be a different firm. This fallacy affects as well the studies arguing that hedge fund activism is value decreasing on the grounds that comparable companies, which have not been engaged, outperform engaged companies in the long run (Cremers et al. 2016).

In theory, whether hedge fund activism is efficient depends on context. Some companies benefit from the correction of underperformance fostered by activist hedge funds, particularly in the presence of investor expropriation or misuse of free cash. For other companies, though, underperformance is temporary and the change of strategy promoted by hedge funds can indeed destroy value. The disagreement on the proper length of time in which to assess performance reflect a more fundamental conflict between two views of the target firm, one by the activist hedge fund and the other by the incumbent management. These views normally differ on strategic issues, such as whether the company should be leaner, more focused on certain businesses and cost-effective in carrying them out, which hedge funds typically like to see perhaps because they are impatient to cash in the profit from engagement. The opposite view that the company should pursue longer-term goals, typically fostered by the management, is equally legitimate although it may procrastinate the acknowledgment of mistakes or conceal the extraction of private benefits of control. For this reason, hedge fund activism should be framed as a conflict of entrepreneurship (Pacces 2016).

Who Decides on Hedge Fund Activism

Framing hedge fund activism as a conflict of entrepreneurship brings up the question who

decides on the conflict and whether this is efficient. As explained before, hedge funds need to garner institutional investors' support in order to succeed. Institutional investors, however, differ considerably from each other in terms of investment strategy and incentives. Their propensity to exercise voice to support or to stop hedge funds likewise differs.

Based on Bushee (1988), institutional investors can be broadly characterized as transient (small stakes, high turnover), dedicated (large stakes, low turnover), and quasi-indexers (small stakes, low turnover). According to Hirschman (1970), a fundamental activator of voice is loyalty, that is, a commitment not to exit. Transient and dedicated investors are not loyal. The former enter or exit whenever there is a tiny profit to make, as is the presence of hedge fund engagements. The latter compete with hedge funds on entering and exiting portfolio companies timely. Only quasi-indexers, exemplified by index funds, are loyal in Hirschman's sense.

Index funds are likely to be the decisive institutional investors in a hedge fund campaign. They cannot exit an investment they are dissatisfied with, so long as this investment is part of the index they track. Thus, they are committed to exercising voice. Empirical evidence seems to confirm this. Ownership by index funds in the USA increases the frequency and the success rate of hedge fund engagements requiring high voting support to succeed (Appel et al. 2016). Apart from this, however, very little is known about how index funds vote or are expected to vote on a hedge fund campaign. Assuming that index funds are indeed pivotal, whether they are the right arbiters between the opposing views of hedge funds and incumbent managers depends on context.

To illustrate the conflict of entrepreneurship with an example, a strategic issue on which the views of activists and incumbent management typically collide is quality and quantity of R&D expenditures. Activist hedge funds want companies to focus on developing specific products, which usually results in cuts of R&D expenditures and larger short-term profits. The managers usually ask for the return on R&D expenditures to be assessed over a longer horizon. Reducing R&D expenditures does not necessarily imply that a company is less innovative. There is evidence that activism increases R&D productivity and output. Hedge fund activism, however, systematically reduces R&D input. This may be not the right choice for a number of companies. In particular, nonlinear innovation with long lifecycles benefits from conglomerate structures in which R&D input is large and can be redirected internally from a project to another. Those are precisely the structures that activists seek to break up.

Drawing on their long-term commitment to index tracking, managers of large index funds, such as Blackrock and State Street, have recently made public statements to distance themselves from the short-termism of activist hedge funds. However, such statements must be taken with a grain of salt. Whereas regulation effectively compels index fund managers to vote, they do not have the right incentives to decide on firm strategy. Index fund managers cannot benefit from firm-specific monitoring because their competitors can free ride (Bebchuk et al. 2017b). In pursuing relative performance, index fund managers will rather choose low-cost voting policies that are generally appreciated by investors. That is to say, index funds may support a hedge fund's request to cut on R&D expenditures not because it is efficient, but because the target has poor corporate governance. Whether it is efficient for the particular company to engage in linear or nonlinear innovation is a more idiosyncratic question than an index fund manager can answer. And yet the choice whether to invest for the long term or focus on short-term should depend on firm-specific variables, such as the competitive environment and the length of the innovation cycle.

Relying on the judgment of index funds is efficient in other situations. Often, what prompts hedge fund activism is waste of resources. Because index funds are expected to vote in a standardized, predictable fashion on a hedge fund's memo showing waste, hedge fund activism protects investors by way of committing management to being efficient. Facing the threat of hedge funds teaming up with institutional investors, managers have to be more careful about misusing

fee cash or being unresponsive to the competitive environment. In this perspective, hedge funds activism is a tremendous tool to stop management from being lazy or building empires.

In conclusion, index funds cannot always be trusted to screen hedge fund activism because they do not have incentives to make an informed decision on individual company's strategy. Nevertheless, the incentives of index funds are aligned with the interest of the investing public regarding the control of agency costs. Therefore, the problem whether a company should be exposed to hedge funds activism does not warrant a one-size-fits-all solution. Different companies may need different degrees of exposure to activism at different points in time. As a result, individual companies should be able to choose the exposure of management to the scrutiny by hedge funds and to alter this choice over time.

Policies Towards Hedge Fund Activism

Similarly to hostile takeovers, hedge fund activism is a disciplinary mechanism in corporate governance. If anything, activism is more effective than hostile takeovers to keep managers on their toes because it is cheaper to operate. Unsurprisingly, hedge fund activism has attracted as much criticism as hostile takeovers used to do, if not more. As a result, a number of one-size-fits-all policies have been proposed to fend off hedge fund activism.

The business model of activist hedge funds is based on the purchase of a "toehold" of undervalued stock to secure a reward for screening the market for potential targets. If target identification were revealed before the engagement, other investors would free ride on hedge funds' investment and reduce, if not eliminate, their reward. Free-riding is a mechanism that fundamentally undermines hedge fund activism, as it undermines hostile takeovers for comparable reasons. By nurturing free riding, the regulation of ownership disclosure and shareholder identification curbs hedge fund activism across the board.

The purpose of ownership disclosure is to reveal the build-up of significant stakes in a company. This is important information for the investing public and the company's management. Regulation mandates transparency of large ownership on both sides of the Atlantic. The specific rules, however, differ between the USA and the EU. In the USA, ownership disclosure is triggered by the crossing of a 5% beneficial ownership threshold, after which the shareholder has 10 days to disclose its stake. These rules are sufficiently lenient to make the USA one of the legal environments most favorable to hedge fund activism. Although EU regulation also mandates a 5% beneficial ownership threshold, the time window to disclose it is shorter (4 days), and more important, these are only minimum requirements. The EU member states can and do set lower thresholds and shorter time windows, for instance in the UK, Italy, and the Netherlands. These stricter rules make hedge fund activism less profitable and thus less likely to happen.

In the USA, attempts have been made to curb hedge fund activism through stricter rules on ownership disclosure. Antiactivist legislation is well illustrated by the so-called Brokaw Act, proposed in 2016 by Senators Bernie Sanders and Elizabeth Warren (Brav et al. 2016). This proposed legislation took on board several previous anti-activist proposals (Coffee and Palia 2016). In the Brokaw Act, the most important curbs to hedge fund activism are: (a) shortening the disclosure period from ten to two days and (b) conferring upon the Securities Exchange Commission (SEC) the authority to determine when a group of hedge fund acted as wolf pack, and to mandate disclosure accordingly. The Brokaw Act has not become law at the time of writing.

In the EU, curbs on hedge fund activism have been adopted not by altering the regulation of ownership disclosure, but by introducing EU-wide shareholder identification obligations (Pacces 2017). Different jurisdictions have different rules on shareholder identification. In the USA, institutional investors can opt out of identification altogether. The EU rules, instead, seek to harmonize shareholder identification rules by requiring that all shareholders above 0.5% be identified by the company's management and the investing public. Differently from ownership

disclosure, the purpose of shareholder identification is to facilitate coordination between non-controlling shareholders. Whereas this policy seems consistent with encouraging the engagement of institutional investors, which is a goal of the EU, the cost of shareholder identification for corporate governance may be higher than the benefits (Enriques et al. 2010). Particularly the cost for hedge fund activism can be substantial, unless hedge funds manage to circumvent identification and purchase several toeholds without crossing the 0.5% threshold.

Ownership disclosure and shareholder identification are two examples of regulation curbing hedge fund activism across the board. As argued before, such one-size-fits-all curbs are inefficient. Law should enable individual companies to tailor exposure to activism to their circumstances, for instance, depending on whether is optimal for them to profile on short-term or longer-term strategies.

In several jurisdictions, companies can effectively opt out of hedge fund activism through dual-class shares, which are interesting relative to other antiactivist tools (such as low-trigger poison pills) because they commit some of the controller's own wealth to the claim that a project must be evaluated in the long term. The problem is that dual class-shares can only be introduced before the company has gone public, unless they are presented as loyalty shares. Formally, loyalty shares provide super-voting rights to any owner that retains the shares for long enough – say, 2 years. Practically, however, loyalty shares are only interesting for controlling owners, because institutional investors are reluctant to give up the higher liquidity of common stock regardless of the average length of their investment horizon.

Both dual-class and loyalty shares confer upon the controlling management super-voting rights. A founder concerned with the adverse impact of activism on certain styles of innovation can go public with dual-class shares, as for instance, Google did. In already listed companies, however, the management cannot exchange existing shares for two classes of shares, one with higher voting rights for the controlling group and one with lower voting rights for the investors. Such dual-class recapitalizations are prohibited. Loyalty shares are a way out of this prohibition. Companies can issue them after having gone public because, formally, loyalty shares do not discriminate between shareholders. European legislation, for example in France, has sometimes gone as far as to allow the introduction of loyalty shares even despite the opposition of a majority of institutional investors.

Loyalty shares are a good instrument for individual companies to tailor exposure to hedge fund activism. However, managers could abuse their power to introduce them. It would be more efficient to allow dual-class recapitalizations explicitly and subject them to a veto by institutional investors. The ex-ante approval of such transactions by a Majority of Minority shareholders (MOM) is a good regime to support contracting between management and shareholders in the midstream. If a MOM vote is required to introduce dual-class shares, the management will have to persuade institutional investors that insulating the company from hedge fund activism, perhaps for a limited time, is value increasing.

Conclusion and Future Research

This entry discusses the role of hedge fund activism in corporate governance. Activist hedge funds are an important source of feedback in corporate governance. However, their influence is not always efficient. Although other institutional investors are decisive on a hedge fund campaign, their judgment cannot always be trusted. In particular, index funds appear to be most often decisive on a hedge fund campaign. However, they do not have the right incentives to decide on company's strategy. On the contrary, the optimal decision whether a company should be managed for the short or the long term depends on the circumstances faced by the individual company. Therefore, individual companies should be able to tailor exposure to hedge fund activism to their needs and to alter this choice over time.

We still do not know enough about hedge fund activism, because most part of it happens behind closed doors. In order for companies and legislatures to fine-tune the rules on hedge fund activism, it would be useful to know more about how

institutional shareholders actually vote and whether different categories of institutional investors are decisive on different campaigns. Moreover, it would be good to know more about the role of coalitions in determining success of hedge fund activism. These are interesting topics for future research.

Cross-References

- ▶ Concentrated Ownership
- ▶ Governance
- ▶ Hirschman, Albert. O.
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Heilbroner, Robert

Cyrille Ferraton[1] and Ludovic Frobert[2]
[1]Université Montpellier 3, Montpellier, France
[2]Centre National de la Recherche Scientifique, Paris, France

Abstract

In this entry, we would like to show that Robert Heilbroner was not only the author of the famous best seller, The Worldly Philosophers, first published in 1953. Actually, he was an active and innovative scholar investigating many subjects, from development to finance, learning constantly on Marx, Keynes, or Schumpeter, and crossing boundaries between many social sciences. However the very core of his project remains a general inquiry on the nature and evolution of capitalism. He could

be considered as a late representative of institutionalism and a brother in arm of economists like John Kenneth Galbraith, Gunnar Myrdal, or Allan Gruchy. It is in the context of this general inquiry on capitalism that Heilbroner presented his main contributions to law and economics.

Introduction

Robert Heilbroner is mainly recognized as the author of an economics best seller, *The Worldly Philosophers: The Lives, Times, and Ideas of the Great Economics Thinkers* (1953). It is very likely that this success partly masks his numerous other works, bearing especially on political economy, capitalism, socialism, or economic methodology.

Critical of the orientation taken by economic analysis post-*General Theory* for its historical and depoliticized nature, Heilbroner continued to argue for a situated and historical approach which takes account of the political, sociological, and moral dimensions of economic change. In this way, economic philosophers such as Adam Smith, David Ricardo, Karl Marx, Thorstein Veblen, Joseph Schumpeter, and John Maynard Keynes, all embraced economic, social, political, and psychological problematics.

Their analyses aimed simultaneously to understand and act, with the view of adapting and controlling the capitalism of their times. Therefore they were not reducible to technical dimensions or expert assessments as many contemporary economic works are. As the objectivity which those aimed for seems to him to be a vain quest, Heilbroner considers that all research supposes a "vision," a notion borrowed from Joseph Schumpeter, who defines this as a "pre-analytic cognitive act" comprising political motivations, social stereotypes, value judgements, etc. (cited in Heilbroner 1993b, p. 89). This vision permeates the analysis for it is constitutive of all social thought, and also because it is a psychological, even an existential necessity. And as such it does not constitute "correctable weakness" (Heilbroner 1996, p. 47). Ideology leads to not recognizing the rôle played by this "vision."

The object of economic study is not given; it is constructed and isolated from social reality. On this point, Heilbroner moves away from conventional economics which reduces its object to a method, a science of choices, so as to privilege a "substantive" definition, in the sense of Karl Polanyi. A definition takes account of institutional configurations and social interactions in the supply of resources to societies. Thus he considers that any economic system, capitalism today, or in the past traditional or planned economies, remains transitory, historically situated, and susceptible to undergoing future changes.

Biography

Heilbroner was born in 1919 in New York. While studying at the University of Harvard, he was influenced notably by Alvin Hansen, Paul Sweezy, and Joseph Schumpeter. But his predilection for economic philosophers and history was truly expressed some years later at the New School for Social Research at the side of his master Adolph Lowe (1883–1995) during a "fascinating seminar on Adam Smith" (Heilbroner 1953, p. 7). Heilbroner shared with Lowe little interest in contemporary economic analyses which treated the environment – social, cultural, political, etc. – as given, while the originality of most economists up to Keynes was precisely the proposal of a general and heuristic vision of the present and the future of the capitalist system, integrating into their analyses elements as important as politics, culture, and social questions.

Heilbroner attempted in turn to adopt this approach in his work and particularly in those bearing on capitalism, which constituted one of his preferred objects of study (see especially *The Nature and Logic of Capitalism* (1986), *Behind the Veil of Economics: Essays in the Worldly Philosophy* (1988) and *twenty-first Century Capitalism* (1993a)).

He was astonished at the almost complete disappearance in economic discourse of the notion of capitalism to the advantage of supposedly more neutral terminology such as "free market society." Reduced to a simple technical study of

market functioning, contemporary economic work neglected the fundamental rôle of the state by evacuating the cultural values and social foundations upon which the capitalist economy rested. The analysis of institutions, involving collective representations and judicial rules as much as social organizations, constitutes an indispensable condition for understanding the *nature* and *logic* of capitalism. Conventional economics thus conveys a political and social "vision" directly inherited from capitalism which it refuses to admit. Economic reality is not identified with an unconscious emergent social order; the state and other institutions have participated and participate in its structuring. The great majority of economists do not recognize "the fundamentally social and political nature of all economies – that is, the core of political and social norms that provide the drive and the acquiescence without which no economic system, especially if marked by great inequalities, would long exist" (Heilbroner 1998, p. 4).

Innovative and Original Aspects

He borrowed from Marx the idea according to which accumulation of capital constitutes the driving force of capitalism but taking into consideration the psychological and psychoanalytic deciding factors that underlie this logic of acquisition. So, it is less conscious than unconscious motivations which explain acquisitive logic and "specifically the universal infantile need for affect and experience of frustrated aggression" (Heilbroner 1998, p. 37).

The principal motivation for the accumulation of capital should be sought beside the power and the prestige that it confers. It is about satisfying a need for domination anchored in childhood which in capitalism has no inhibition, contrary to noncapitalist societies which have succeeded in limiting it culturally. The search for profit plays an equivalent rôle to territorial conquest for military regimes or to increasing the number of the faithful for religions. Hierarchy, power, and domination are thus inseparable from the accumulation of capital. The analysis of individual choices which conventional economics is focused on is incapable of giving an account of this ensemble of logic which can only be understood from a sociopolitical approach.

The markets which permit the allocation of resources and the coordination of economic activity constitute the institutional economic basis of capitalism. But taken in isolation following the model of contemporary economists, they are insufficient to qualify capitalism and notably cannot permit an understanding of the logic of acquisition.

Finally, the distinction between a public sector, place of power, and a private sector, in which market economic activity is deployed, represents a last central characteristic of the capitalist system. This distinction constitutes a historical particularity as economic activity relying on its own rules, autonomous from the rest of social activities, does not exist in noncapitalist societies. Neither do societies isolate the exercise of authority in a delimited sector. This separation is thus a source of liberties, as political dissidence can find in the economic sphere sources of expression that are inconceivable in noncapitalist societies.

However, far from being opposed, the two sectors are mutually dependent, as the accumulation of capital is not able to be achieved without the support of the state on the one hand and a prosperous economy is necessary for the financing of public activities on the other. The state even has a priority: supporting the accumulation of capital upon which depends its financial resources. Keynesianism and its inverse, the economics of the fight against inflation of the 1980s, have displayed how the capitalist system is now connected to and dependent upon the political order. The state intervenes in the economic field not to transform it or for ideological reasons but so as to secure its own future. Economic thought recognized, with Keynes, the state as an economic actor but always as a necessary interference and not as an integral part of the social capitalist order.

Identically, there is, in Heilbroner, a delegation of public functions to capitalist functions, in particular in the organization of work within the productive sphere. This is a case of an "unrecognized transfer of political power from the state into private hands" (Heilbroner 1985, p. 100). The opposition between public and

private, often presented as constitutive of capitalism, is thus brought back into cause since there is mutual interpenetration between the two sectors. Heilbroner undeniably here sees things from the perspective opened up by authors such as Karl Marx or Karl Polanyi for whom the state is a central actor of the institutionalization of the modern economy. The crises which have multiplied since the end of the nineteenth century have shown that the state can use the budgetary instrument to temporarily shore up the defects of the system. But it is firstly by the intermediary of law that the state favorizes the accumulation of capital. Citing Ellen Meiksins Wood, Heilbroner even considers that capitalism represents the ultimate "privatization" of politics "to the extent that functions formerly associated with coercive political power... are now firmly lodged in the private sphere" (cited in Heilbroner 1985, p. 100).

Assimilating capitalism to a uniquely private regime constitutes a gross error. The state, through socialization, by the protection and stimulation of certain economic activities, actively supports capital. Recurrent economic crises have given rise to necessary public interventions showing the adaptable and evolving character of the social capitalist order.

Impact and Legacy

The economic philosophers were perfectly aware of this interpenetration of the private and public sectors which constituted in their eyes an indispensable condition to the accumulation of capital of a stable social order. Heilbroner emphasizes that the economic philosophers always envisaged a "bounded future" for capitalism (the stationary state in David Ricardo, associationist socialism in John Stuart Mill, etc.) (Heilbroner 1985, p. 143). It was to prevent or delay these potentially dramatic episodes that they conceived such vast enquiries with economic dimensions but also with social and political and positive and normative aspects.

Cross-References

► Capitalism

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Heterarchy

Erwin Dekker[1] and Pavel Kuchař[2,3]
[1]Erasmus School of History, Culture and Communication, Erasmus University Rotterdam, Rotterdam, The Netherlands
[2]Department of Economics and Finance, University of Guanajuato, DCEA-Sede Marfil, Guanajuato, GTO, Mexico
[3]Facultad de Economía-División de Estudios de Posgrado, Universidad Nacional Autónoma de México, Ciudad de México, México

Abstract

Whenever agents choose A instead of B, B instead of C, and C instead of A, a logical contradiction arises. This contradiction – also known as a value anomaly – characterizes genuine choices. Some organizations and firms, but also legal systems, markets, or even the human brain can be regarded as complex systems that manage the value anomaly by operating with multiple mutually incompatible ordering principles. Such a management – as opposed to a mere elimination – of these mutually incompatible values allows these systems to better cope with uncertainty, and to benefit

from the recognition of complexity. One of the central implications of these heterarchical systems is that there is no single scale on which unequals can be compared and, consequently, that commensuration is an active process which involves friction and opportunities for entrepreneurship. We argue that in a world that naturally seems to be characterized by these value anomalies, heterarchical organizations and, in particular, heterarchy as a complex system of valuation might well be a good response.

Definition

Heterarchy is a complex adaptive system of governance, an order with more than one governing principle. Heterarchies include elements of hierarchies and networks, but in a number of important ways, heterarchies are different from both of these systems of governance. The model of heterarchical governance is like plate tectonics: mutually self-contained orders with unclear hierarchies among them.

Origins of the Concept: A Value Anomaly

The concept of heterarchy dates back to 1945 when Warren S. McCulloch, a neurophysiologist, presented a problem defined by a logical contradiction that is characteristic for any system (be it a group of neurons, an individual, or an organization) that chooses A instead of B, B instead of C, and C instead of A. This value anomaly is present in any system that has to make a choice between two or more potential acts that are incompatible (McCulloch 1945, 90; cf. Shackle 1979). Without the logical contradiction – without two or more potential acts that are incompatible – there is no space for a genuine choice based on disparate evaluation criteria. A decision ultimately relying on an algorithm, on an overarching metric, suffices.

Law and economics as a discipline has been defined by such a logical contradiction. The field has forever faced a tension between the internal order of the market and the internal order of the law. One tendency, when faced with such a heterarchy of values, is to attempt to regulate or otherwise clear up the conflict by defining and applying a hierarchy of values. This approach has been adopted by scholars developing the economic analysis of law, which is aimed at demonstrating that law really is about efficiency (Posner 1973).

Hierarchies of Values, Commensuration, and Genuine Choice

Whether we like it or not, conflicting demands and contradicting values form integral parts of complex systems which cannot be reduced to a single ordering principle. What is right may be, sometimes at least, fundamentally at odds with what is efficient, and getting rid of the heterarchy of values might be the wrong approach to begin with. A growing number of social scientists have recognized that heterarchies actually have strengths of their own, which we often fail to appreciate. These scholars suggest that our brain (Bruni and Giorgi 2015), firms and organizations (Hedlund 1986, 1993; Hedlund et al. 1990; Girard and Stark 2003), constitutional legal systems (Joerges et al. 2004; Halberstam 2008), and systems of global governance (Baumann and Dingwerth 2015) are all examples of heterarchies and that the value anomaly which McCulloch identified is a feature that defines these systems, not a bug to be done away with. Heterarchy seems to be the natural state of the world, and heterarchical organizations (including the brain) might well be a response to that world.

In a heterarchy of values, different and often incompatible logics of what is valuable are at play. Yet, the difficult requirement to reconcile incompatible situational logics may be eliminated by transforming qualities into quantities, in other words, through commensuration. When an overarching value like efficiency, equality, or fairness is found, the choice is reduced to figuring out which option scores better on the value metric. Commensuration transforms the system with a heterarchy of values into one with a

hierarchy of values. In such a system, a genuine choice between incommensurables is not necessary, it is in fact ruled out. While commensuration seems to be a sine qua non for a rational choice, the acceptance of a hierarchy of values might have performative collateral effects – commensuration may transform the character of one's decision-making effectively turning one's passions from something boundless and elusive to something graspable and orderly (Nussbaum 1986). The danger of such a transformation is that when it happens, we "must see the beauty or value of bodies, souls, laws, institutions, and sciences, as all qualitatively homogeneous and intersubstitutable, differing only in quantity" (Nussbaum 1984, 68; cf. Mill 1863); when such a transformation happens in economics, we become convinced that the relation between any two desired things is always conceived of as a problem of making the right trade-off.

Heterarchy, Incommensurability, and the Exchange of Unequals

Claims about incommensurability are typically made where different modes of valuing overlap and conflict with one another (Espeland and Stevens 1998). This happens at the intersection of diverse systems of worth that sustain disparate mental models and justify conflicting institutions and situational logics. But while some kind of commensuration is necessary for markets to exist, making artifacts commensurable requires effort; no artifacts – be it persons, goods, and organizations – are essentially commensurable on their own (Dekker and Kuchař 2016).

When people trade they exchange artifacts which they value less for other ones they value more. Trade is thus an exchange of unequals but possibly also of competing principles or notions of worth (think, e.g., about the legal differences between goods and persons). If one artifact is to be traded for another in a market, conflicting principles of valuation have to be reconciled through commensuration. Legal scholars often treat this question as a formal matter, what is necessary is a system that turns possession into property. It seems to be the case, however, that equally necessary, perhaps even a prerequisite for trade to happen in markets, is a social process that by way of commensuration legitimates trade. And indeed, market interactions are embedded in frameworks that make comparisons of unequals possible and that legitimate these comparisons. These institutional frameworks enable agents to negotiate between different modes of valuing that make up the heterarchy of values.

Entrepreneurship and Legitimation of Markets

The social process of commensuration requires entrepreneurial action because trade is not naturally legitimate. We highlight three points why this is so: First, as we have demonstrated elsewhere, some broader agreement on what an artifact is good for greatly facilitates trade and is required for its legitimacy (Dekker and Kuchař 2017). Such an agreement may emerge when the meaning of exchange is contested. Second, by introducing a good, a price tag is put on the object which makes it comparable with many other artifacts (within a circuit of commerce, cf. Kopytoff 1988). In some cases, this might be considered illegitimate, allowing us to explain the existence of separate circuits of commerce, rather than unified markets (or one big market). This happens when commensuration with (some subset of) other goods is contested. Third, the entire idea of monetary valuation might be resisted, because it devalues the "sacred." How much does a seat in parliament cost? On the margin, how much freedom should we give up to make our markets "more competitive"? Artifacts like voting rights or justice may under some circumstances be considered as unique. When this happens, commensuration with money is contested. In such cases, a unified metric is lacking, and we face a genuine choice.

None of the abovementioned examples rely on strict commensuration in that the artifacts in question are 3 ft long or 5 ft high. But they rely on a commensuration in terms of moral categories. Within these different moral categories and

hence within different circuits of commerce, we will find different norms of ownership and different norms of exchange and redistribution that will lead to different forms of property and contract law on which well-functioning markets rest.

Applications of the Concept Across Disciplines

The idea of heterarchy has been applied in fields such as anthropology, political science and institutional economics, international political economy, organization theory, or sociology. For example, Carole Crumley, an anthropologist, defined heterarchy as "the relation of elements to one another when they are unranked or when they possess the potential for being ranked in a number of different ways" (Crumley 1995, 3). She found hierarchical theories to be inadequate in explaining the emergence of modern states. In her seminal paper, Crumley criticized the idea that order in human society must rest on hierarchical systems of governance mechanisms pointing toward a "conflation of hierarchy with order [that] makes it difficult to imagine, much less recognize and study, patterns of relations that are complex but not hierarchical" (Crumley 1995, 3).

That order and hierarchy do not necessarily come together is a prominent message throughout the work of Elinor Ostrom who suggested that a heterarchical organization of water supply in California (Ostrom 1965) or polycentric organizational structure of public safety provision (Ostrom and Parks 1973) may, in fact, be a good idea for public policy: "not a single case was found where a large centralized police department outperformed smaller departments serving similar neighborhoods" (Ostrom 2010, 644).

The concept of heterarchy has also influenced the study of international relations and sociology of law through the idea of legal pluralism. Legal pluralism may lead to conflicts, tensions, and boundary disputes which often result from collisions between plural discourses of contradictory legal regimes. These tensions present international actors with paradoxical demands. Paradoxical double-bind situations typically arise when the social environment makes ambivalent or contradictory demands to which organizations must respond. The organizational response to these paradoxical situations tends to be neither contract nor hierarchy but hybrid networks (Hutter and Teubner 1993) that may allow for the transformation of external incompatibilities into internally manageable contradictions.

Heterarchies as Complex Systems of Valuation

Inconsistency and contradiction between institutional frameworks can bring about opportunities for innovation and change. On the other hand, the overlap between institutional orders that sustain different modes of valuation are also sites of fierce struggle between different situational logics that give rise to different standards of proper and permissible behavior. When institutional frameworks that sustain conflicting modes of valuation overlap, uncertainty arises. This uncertainty creates opportunities for proponents of alternative modes of valuation that legitimate certain applications of novel artifacts. In such a perspective, entrepreneurship is not seen as a property of individual proponents of particular modes of valuation. Rather, entrepreneurship is a property of a group that may or may not allow for a heterarchy of values (Stark 2009).

Heterarchies are complex adaptive systems precisely because they interweave a multiplicity of criteria according to which performance may be evaluated, esteemed, or appraised. These heterarchies of worth are organizational structures in which a given element may simultaneously be expressed in multiple overlapping networks that maintain separate situational logics and that constitute separate orders of worth (Stark 2017; cf. Boltanski and Thévenot 2006). Contending frameworks can themselves be a valuable organizational resource that fosters entrepreneurship by bringing about uncertainty. Consequently, entrepreneurship as a feature of an organizational structure consists in the ability to keep multiple evaluative principles in play and to exploit the resulting friction that arises as a result of their interplay. Entrepreneurship exploits indeterminacy

by keeping open diverse performance criteria rather than by fostering consensus about one set of rules that would apply to every element in the whole system.

Cross-References

- ▶ Consensus
- ▶ Economic Analysis of Law
- ▶ Entrepreneurship
- ▶ Law and Economics

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Hidden Economy

- ▶ Informal Sector

Higher Education

Karsten Mause
Department of Political Science (IfPol), University of Münster, Münster, Germany

Abstract

This entry discusses the role of the market, the state, and the law in the higher education (HE) sector from a law and economics perspective.

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Definition

The term "higher education" (HE) is mainly used in three related contexts. First, it is used to denote the level to which individuals have pursued their educational careers. A person who finished high school and, thereafter, received a degree from a college, university, or another HE institution is someone who possesses an HE – compared to individuals with lower levels of formal education as measured by degrees or years of schooling. Second, as will be discussed below, some claim that HE institutions offer (potential) students HE as some kind of commodity. And third, social scientists consider HE as a subsector or subsystem of modern societies alongside other societal areas such as the economic and legal system.

The Market

It is often argued that HE is a commodity which is supplied by universities and other HE institutions and demanded by students in the HE marketplace. On closer inspection, however, this simple HE-as-commodity analogy is misleading and needs some clarification from an economic perspective. What HE institutions in fact provide are academic programs which contain goods and services (lectures, tutorials, course material, etc.) that students may use during their course of studies. Moreover, HE institutions award degrees which students receive after the successful completion of a degree program. Students normally have to work hard to pass the required examinations – however, there are also so-called diploma or degree mills that sell credentials that require little or no study (Grolleau et al. 2008). While selling "fake" degrees or doctorates is not necessarily illegal, whether a "degree" from an obscure "university" really pays for the respective "degree" holder in terms of labor market success, social prestige or in another respect is a different matter.

Another issue, which is frequently discussed under the keyword "grade inflation," is that it is by no means clear that graduates holding excellent degrees (as measured by excellent grades) awarded by more or less prestigious HE institutions are likewise excellent in terms of knowledge and skills (Popov and Bernhardt 2013). Moreover, given the vast amount of institutions sailing under the flag "college" or "university," one has to take a careful and critical look at the curriculum a particular degree-granting institution is providing (Altbach 2001). In the labor market, potential employers therefore have to cope with the problem of asymmetric information in the sense that they have to find out whether graduates' labor market signals are credible – and which knowledge and skills a particular graduate of a certain college or university really possesses (Rospigliosi et al. 2014). In the HE systems of many countries, however, institutions have evolved that may help (potential) students and employers to overcome their informational problems. For example, university rankings and guidebooks try to separate good from not-so-good program providers. Accreditation agencies check whether programs and their providers fulfill certain quality standards – and, if so, award a seal of approval. Governmental authorities evaluate the quality of HE institutions and programs and award the label "state recognized." And the good or bad reputation of a program and its provider can be considered as a market-based institution providing quality information (McPherson and Winston 1993; Mause 2010).

While academic programs and degrees are supplied by public and private HE institutions in markets, these institutions do not directly provide the market good "education." The latter is in the possession (more precisely, in the head) of an individual. And what students can do is use the educational services (lectures, seminars, mentoring, textbooks, etc.) contained in academic programs to expand their already existing personal stock of education. The fundamental distinction between HE and educational services offered by HE institutions is not just a wordplay but refers to the real-world issue that "not all 'schooling' is 'education,' and not all 'education' is 'schooling.' Many highly schooled people are uneducated, and many highly 'educated' people are unschooled" (Friedman and Friedman 1980, p. 187).

Following this conceptual differentiation, HE is not a commodity like cheese or wine which can be bought in a market, as it is sometimes claimed in public debate. By contrast, the "customers" of HE institutions are producers of their own education: i.e., students have to invest time and effort to educate themselves with the help of the HE institutions' staff members and services. These institutions may create an excellent learning environment and offer a state-of-the-art curriculum; yet, whether and how students use the provided support is another issue. And students or external observers (e.g., parents, education experts, or politicians) that are dissatisfied with "bad" lectures, seminars, professors, and so on should reflect that successful "service provision" within an academic program to some extent requires the active participation of the particular "client" (Rothschild and White 1995). In other words, there are limits to what HE institutions can do to achieve that their students are really learning and enhancing their knowledge and skills.

The State

In many if not all countries, governmental authorities play a role in the HE marketplace as characterized above. Governments at different jurisdictional levels, for instance, may be providers of academic programs. In Germany, the USA, and many other countries, there are not only private HE institutions but also public universities which are state owned and publicly subsidized to some extent. A political rationale for such governmental intervention is that "the state" intends to safeguard that the HE sector produces a sufficient number of graduates in various fields of study; a highly qualified workforce is regarded as essential to ensure the wealth of a nation and its international competitiveness. From an economic perspective, the expectation that there will be a private "underdemand" (i.e., "too few" students and graduates) and/or private "undersupply" ("too few" program providers) in certain fields of study may be an economic argument to justify government intervention in the form of public ownership and/or public funding of HE institutions. However, due to the difficulty to forecast the future, there is a danger that governmental efforts to avoid "underproduction" and to steer the *quantity* of graduates (e.g., public funding, information campaigns) may lead to "overproduction." That is, a well-meaning government action to stimulate demand and supply in fields where a "shortage" of graduates is diagnosed may promote the production of large numbers of graduates who subsequently have problems finding a job to match their academic qualification (Freeman 1976; Büchel et al. 2003).

In addition to governmental efforts to steer the demand and supply of academic programs, the state may intervene in the HE marketplace by regulating the *price* students have to pay for attending these programs. For example, to politically enable citizens from all social strata to go to university, currently in Germany students at public HE institutions generally do not have to pay tuition fees. The state may also regulate the *quality* of academic programs. The government may, for instance, influence what is taught and how it is taught at "its" public HE institutions. Moreover, governmental authorities could, via mandatory evaluations, monitor what is going on at private HE institutions (quality of curricula, teaching staff, graduates, etc.) and intervene if deemed necessary. From an economic perspective, it should be mentioned that there are private governance mechanisms which may be a complement or – under certain conditions – even a substitute for a direct governmental quality regulation by public bureaucrats: private accreditation agencies, university rankings by reputable organizations and media, or an HE institution's good or bad reputation may likewise help (potential) students to separate good from bad quality and to make informed choices (McPherson and Winston 1993; Mause 2010). Whether a public, private, or public-private quality regulation in a jurisdiction's HE system is perceived as appropriate, in democratic societies, is decided by the political system.

Furthermore, the government may control the *market entry* of providers of academic programs. In Germany, for example, governmental authorities check whether an HE institution and its

programs fulfill certain quality standards. This form of mandatory licensing is practiced mainly for the purpose of quality assurance and "consumer protection." From an economic perspective, however, it is by no means clear that spending public money for public bureaucrats who control market entry is necessary: because it can be expected that no potential student (or only a few) will enroll in a program whose provider is not able to credibly signal in some way (e.g., via a seal of quality awarded by a reputable accreditation agency, well-appointed buildings and rooms, hiring some renowned professors, etc.) that it will offer students a high-quality program, value for money, and a degree that is recognized in the labor market. In other words, private governance mechanisms under certain conditions may be a substitute for governmental market entry control (Mause 2008).

And the Law

In many societies "the law," which again may be influenced by government action, plays an important role in facilitating exchange in the HE marketplace (Russo 2010, 2013). For example, in the USA, the UK, and other countries, students enter contractual relationships with HE institutions. Students dissatisfied with the contractually agreed services can appeal to a court in order to legally enforce their "student contract." Such contracts can be interpreted as another form of consumer protection in the HE sector: by this means, "student-customers" are to some extent protected by contract law (Farrington and Palfreyman 2012; Kaplin and Lee 2014).

There are other settings where students do not sign an explicit contract. This is currently the case, for example, at public universities in Germany. In this particular case, however, students study under the umbrella of public and administrative law. If, for instance, a department deviates from what is stipulated in the official study and examination regulations, dissatisfied students can appeal to university's internal bodies (e.g., examination office), to the Ministry of Education of the state in which the public university is located, or to an administrative court. To conclude, there are not only governmental but also private governance and legal mechanisms that govern the HE marketplace. All these governance mechanisms are imperfect and have their respective limitations. The relative performance of these mechanisms can only be assessed by means of an in-depth comparative institutional analysis of real-world markets.

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Hijacking

► Piracy, Modern Maritime

Hirschman, Albert. O.

Cyrille Ferraton[1] and Ludovic Frobert[2]
[1]Université Montpellier 3, Montpellier, France
[2]Centre National de la Recherche Scientifique, Paris, France

Abstract

This entry will provide insights into Albert Hirschman intellectual trajectory and major concepts. We will over the main steps of his academic career and his major contributions to several and multidisciplinary fields. On the issue of law and economics, the entry underlines his high preference for pragmatic institutions (voice and the political arts of participation and deliberation at different social scales) and his everlasting caution to organic institutions (exit and spontaneous market mechanisms). However, we also state that in some of his contributions, Hirschman tried to rehabilitate, in an original and balanced way, the benefit consequences of organic institutions on the issues of growth and especially development.

Biography

We can single out two main times in the work of Albert Hirschman (Adelman 2013; Ferraton and Frobert 2003; Meldolesi 1995). The first one is devoted to development economics, a domain he is considered to have pioneered. This period laid the foundations of his approach thanks to the publication of *The Strategy of Economic Development* (1958). In retrospect, Hirschman explained that in these works his ambition was to "celebrate" and "sing the epic adventure of development, its challenge, drama and grandeur" (Hirschman 2015, XVI). Then, around 1970, he wrote more general and cross-disciplinary works around Economics, Political Science, Sociology, History, and other social sciences. It was in 1970 that *Exit, Voice and Loyalty* appeared, which was to be followed by other contributions now considered as classics, such as *The Passions and the Interests* (1977) and *The Rhetoric of Reaction* (1991).

Of course, a sense of continuity and even unity can easily be found between the two series of contributions. Many commentators, from Michael Piore to, in the present day, Jeremy Adelman or Dany Rodrik, have emphasized the special, personal dimension of Hirschman's work. A dimension revealed by a capacity to invent notions which are at once disconcerting and enlightening – such as the *Principle of the Hiding Hand* or the *Blessing in Disguise* – by a constant effort allowing problems to be mapped out, and so to be solved, by the habit of working upon language and by combining the paths of literary and scientific enquiry, etc. Even if he always avoided offering universal methodological solutions, Hirschman nonetheless sketched out the tacit rules of his approach: possibilism. Resisting any positivism, he emphasized that his research was "pervaded by certain common feelings, beliefs, hopes, and convictions and by the desire to persuade and to proselytize which such emotions." To clarify his credo, he adds "for the fundamental disposition of my writing has been to push back the limits of that which is or is perceived as possible, be that at the price of a weakening of our capability, real or supposed, to discern that which is probable"; and for to this purpose, to constantly "underline the multiplicity and creative disordered of the human adventure, to bring out the uniqueness of a certain occurrence, and to perceive an entirely new way of turning a historical corner" (Hirschman 1971, 26–27)

Fashioned in this way, the iconoclastic work of Hirschman is partly the result of a tumultuous life, the academic side of which began relatively late. Very early on, and notably in 1930s Germany, he was able to observe at first hand the apparent omnipresence of violence in human transactions,

the tendency of societies, including the most advanced, to be rotted away by an apparently inexorable process of brutalization. At the origin of this process, multiple processes of decline can be observed (for nations and civilizations), and of failure or falling activity (for organizations and businesses). How can warning be given and then action taken when decline or falling activity are displayed? Against all fatalism, Hirschman chooses to interest himself in the intrinsic capacity of adaptation of human communities, as well as in the conditions of its expression; whatever the scale of the measure, the action is possible and the discourse on the laws, the regularities, the instructions of history, nature or society should be nuanced.

His work constitutes a vast enquiry about principles but also about the craft that can favor the emergence, maintenance, or defense of a reasonable social, political, or economic environment. The question of action which is collective and turned towards reform is thus at the heart of his intention. This explains that he could consider since his first works on Latin America that "the fundamental problem of development consists in generating and energizing human action in a certain direction" (Hirschman 1958, 25), or that he concentrated his later thinking upon "the microfoundations of a democratic society" and to the "constitution of a democratic personality" (Hirschman 1995).

Innovative and Original Aspects

This general orientation thus allows us to approach the question of law/economics in Hirschman. These relations depend on the new and singular fashion by which he treats the question of institutions. We are familiar with the opposition established by Carl Menger between "organic" institutions and "pragmatic" institutions (Menger 1883). "Pragmatic" institutions present themselves as rules and organizations resulting from collective, concerted, and planned action. They make concrete a design consciously developed by one or many individuals. However, organic institutions are the unintentional consequence of intentional individual actions. Put in another way, an organic institution is a social consequence, unanticipated, even unwanted, which is the result of actions undertaken by many individuals independently of each other. Menger explains that numerous social phenomena spring from this process in terms of organic institutions: law, language, the market, and money are all institutions that are at least partly organic.

Within the framework of this alternative, the work of Hirschman swings very clearly to the side of pragmatic institutions. A key contribution such as *Exit, Voice and Loyalty* can thus be interpreted as a defense of the paths of economic, social, and political reform by the privileged means of pragmatic action. Opposing the teachings of *The Logic of Collective Action* by Mancur Olson, Hirschman emphasizes that the efficiency of the process, described by economists as simultaneously spontaneous, optimal and exclusive, that represents the market (*exit)* faced with the different risks of "slackening off" for institutions and organizations, should be questioned. Another process, more determined *(voice)* a characteristic of political action, should, at least be considered as complementary, and doubtless, most often, as a clearly preferable alternative. *Exit* appears thus as a secondary substitute.

Hirschman's preferences concerning the two processes are in fact obvious: while *exit* is taxed as being a form of "desertion," "*voice* is essentially an *art* constantly evolving in new directions" (Hirschman 1970, 43) and again a faculty of invention. He specifies elsewhere that the role of speaking out within an organization can be assimilated to the exercise of a democratic control founded upon the interaction of opinions and interests. In the context of the neoliberal movement of the 1980s and attacks made upon the welfare state, the tendency to favor the pragmatic over the organic will be evident in Hirschman, engagement in favor of public action becoming the supervisor in relation to an activity which is entirely turned towards private well-being (*Shifting Involvments* 1982). A little later *The Rhetoric of Reaction* studied, so as to reveal, the three rhetorical devices systematically mobilized

over the history of the two last centuries by conservative/reactionary opinion (perversity, futility, jeopardy) to stigmatize any determined attempt to improve the civil, political, and economic situation of the greatest number.

Nevertheless, as in all parts of his work, Hirschman tries to question his own opinions (his "propensity to self-subversion") to establish dialogue with the adverse party to improve the conditions of the explanation. Thus, he explains that at the very heart of conservative tradition a concept of social change can be seen, as well as institutions which, correctly reformulated, can be included in the arsenal of the social reformer. In fact, notes Hirschman, the Hayekian paradigm of the unexpected consequences of action and the emergence of organic institutions has too clearly been monopolized, in his opinion, by conservative thought. However, this explanatory model of social change has virtues which would merit their being solicited by progressive/reformist thought.

Progressive/reformist thought, in fact most often mobilizes a model of social change that is too crude: a model stained by Prometheism and in which change intervenes as a mass, from above and according to sequences presented as entirely determinable and planifiable in advance; a model in which actions cannot, nor must not have unexpected consequences; a model in which also dominates as a consequence the expert, the money doctor and others, deus ex machina of a world that is entirely measurable.

However, from his first works on development, as he was confronted with the problem of generalized underemployment of existing but dormant resources which characterizes the least advanced countries, Hirschman asked for the use of a *strategic* approach. In that case, it is necessary, as in the case of the Keynesian multiplier, but to a greater degree of generality, to create an impulse, then let the fertile multiplying phenomena develop. And in this context, it is thus necessary to reflect in strategic terms, that is to say, in terms of actions of impulse at different levels, including and especially at intermediate levels, and at different moments to support much more than fully control the chains of phenomena which will develop.

Hirschman thus explains that, in terms of models of change, a strange twinship can be suspected to exist between the Keynesian model centered on the multiplier and the Hayekian paradigm of action. Starting in *The Strategy,* Hirschman explains that "development planning" thus consists of putting *"inducement mechanisms"* systematically in place. Here there is a clear hope placed in the generalization of certain multiplying phenomena, an initial action leading to an unforeseen chain effect of positive consequences. But here the issue at stake becomes not to declare them, for cognitive reasons or other impotencies vis-a-vis these chains of phenomena, but to learn as much about them as possible so as to recognize them and watch over them. He took up this idea later: "it is possible to plan with success; to put it another way, we are not always surprised by unexpected consequences" (Hirschman 1997, 96).

Impact and Legacy

Originally marked by the experience of totalitarianism, then by field and conceptual work, in the domain of development, and finally by thinking upon the ensemble of history and the social sciences, Hirschman thus presents a complex conception of institutions and the articulation of economics/law. A concept which proceeds from the emergence and the evolution of economic phenomena – here also should be mentioned his micro-Marxism – and which brought his attention to the multiple possibilities which, collectively, offer themselves for the exploitation of their positive dimensions, thus to form obstacles to the incessant risks of decline and failure which menace human organizations and communities.

Cross-References

► Economic Development
► Institutional Economics

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Horizontal Effects

Philipp Schumacher
Wildau Institute of Technology, Technical University of Applied Science, Wildau, Brandenburg, Germany

Definition

Horizontal effects are the anti-competitive consequences of mergers where the competitive constraints existing before the transaction between the merging parties are eliminated (unilateral or non-coordinated effects), and/or the post-merger market structure reduces the intensity of competition between the remaining competitors (pro-collusive or coordinated effects).

Horizontal Effects

Non-coordinated effects refer to a situation where, post-merger, the merging parties are able to profitably increase prices, reduce output, or otherwise act less competitively than before, while their rivals do *not* alter their strategies. Non-coordinated effects arise from the independent profit maximization of the individual firms and are due to the internalization of competition between the merging firms. Before the merger, a unilateral price increase by one party would have led to sales lost to competing firms, including the other merging party. As a result of the merger, the parties can absorb some of the competitive pressures. The incentive to increase prices strongly depends on the closeness (or degree of substitutability) of, firstly, the merging firms' products and, secondly, the existence of close substitutes offered by non-merging firms. Consequently, one of the fundamental elements of the European Commission's Horizontal Guidelines is the assessment of the closeness of competition to forecast non-coordinated effects. In order to determine the cross-price elasticity of demand between several products, economic methodology is required for robust modeling and correct interpretation of the results.

In the Horizontal Guidelines, the EC recognizes that market share is not necessarily the best indicator of market power or non-coordinated effects in the sense of ability to raise prices, and it attempts to include additional economic aspects into the assessment, e.g., the probability of post-merger anticompetitive effects in the absence of any countervailing factors and the probability of buyer power, entry of new competitors or efficiencies as factors mitigating harmful effects on competition, as well as the conditions of a failing firm defense.

A merger is said to give rise to concerns regarding *coordinated effects* when the consequent change of the nature of competition better enables the merged firm and at least one of its competitors to reach and sustain a tacit agreement not to compete effectively with one another and thereby raise prices. A merger may also make coordination easier, more stable, or more effective for firms which were coordinating prior to the merger. Coordinated effects arise if, due to the merger, non-merging competitors change their

strategies, resulting in (or reinforcing previously existing) coordinated behavior, i.e., explicit or implicit collusion. Post-merger, it may be easier for the firms in the relevant market to imitate monopoly-type behavior by acting collectively. The coordination may take various forms, for example, keeping prices above the competitive level, limiting output or new capacity, dividing the market, or allocating contracts in bidding markets (European Commission 2004, para. 40; U.S. Department of Justice 2010, p. 24–29). The likelihood of such behavior is determined by how easy the establishment of coordination is in a given market and how sustainable it is over time, dependent, in particular, on the existence of a credible monitoring and punishment mechanism for deviations. The EC Guidelines require the commission to prove that such conditions exist in the respective market before claiming that sustained coordinated behavior is likely to occur.

According to the Guidelines, coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. Additionally, the following conditions are necessary for coordination to be sustainable:

- The firms in the coordinating group must be able to sustain any tacit understanding. This requires them to be able to monitor that the tacit understanding is being adhered to by the other firms.
- If a firm does deviate from the tacit understanding, the other firms must be able to respond effectively (i.e., retaliate) to penalize that firm.
- For the tacit understanding to be sustainable, it must be immune from the potentially destabilizing reactions of firms outside the coordinating group.

Cross-References

- ▶ Efficiency
- ▶ GE/Honeywell
- ▶ Merger Control
- ▶ Merger Remedies

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Horizontal Product Differentiation

Javier Elizalde
Department of Economics, University of Navarra, Pamplona, Navarra, Spain

Abstract

This essay provides a definition of horizontal product differentiation and a short description of its implications for Law and Economics, as the degree of product differentiation affects the degree of competition and therefore the level of prices. A short revision of the literature on horizontal product differentiation is performed.

The aim of the literature is to predict the number of varieties or the degree of differentiation (when the number of varieties is fixed) in an industry. Different works find different solutions to this problem.

Definition

Horizontal product differentiation takes place when, at a given price, some consumers prefer different varieties of the goods.

Horizontal Product Differentiation

A number of products are horizontally differentiated when, if they were all sold at the same price, all of them would be demanded by one or more consumers. The existence of horizontal product differentiation implies that the market cannot be described by perfect competition but firms enjoy some degree of market power as, if one of the firms increases its price, some consumers would switch to a competitor but some other consumers would keep loyal to their original supplier.

From the point of view of law and economics, the existence of horizontal product differentiation is relevant in order to identify the competitors for goods and therefore to define the relevant market. The degree of product differentiation determines the degree of market power, as the more similar the products, the more intense the price competition.

There are two alternative approaches to the analysis of competition with differentiated products. The first approach considered that all consumers had the same preferences for the different varieties of the goods, which were fixed (Bowley 1924). This analysis was modified by considering endogenous varieties and free entry, in what has been called in the literature the model of monopolistic competition (Chamberlin 1933). The second approach to the analysis of horizontal product differentiation is called the *address (or distance) approach* as it considers the degree of product differentiation as geographical distance between the different firms (Hotelling 1929).

Hotelling analyzed products which were differentiated in only one dimension (in his own example, he considered that cider could be simplified to be differentiated by the degree of sourness alone), and different consumers had different preferences for the different varieties of the goods. In the original Hotelling model, two firms entered simultaneously in a linear market and decided the product characteristic in the first stage and the price in the second stage. Any decision to change the product specification has a price effect and a market share effect: A firm has an incentive to offer a closer substitute to its rival's product in order to gain some of its customers, but this closeness implies a higher degree of price competition. The main goal of the address approach to horizontal product differentiation has been to define the equilibrium in the characteristics (or location) game, which represents the degree of product differentiation in the market. The prediction of Hotelling was that the two firms would be located in the center of the linear market implying minimum product differentiation. It was shown that the analysis of Hotelling failed when the firms where closely located as none of the price or market share approaches dominated the other (d'Aspremont et al. 1979).

The analysis of Hotelling was modified in order to get a perfect equilibrium in the two stages of the game. One of the assumptions that were modified was that the transportation costs of consumers are linear. By considering quadratic transportation costs, d'Aspremont, Gabszewicz, and Thisse solved the problem of nonexistence of equilibrium predicting maximum product differentiation. Other assumptions of the original work (primarily the existence of two firms, differentiation in a single dimension, simultaneous entry, and the fact that all consumers purchase one unit of the goods regardless of price) have been relaxed in recent works finding support for either maximum or intermediate degrees of product differentiation (Prescott and Visscher 1977; Salop 1979; Economides 1984, 1986; Irmen and Thisse 1998).

There are two noteworthy versions of the horizontal product differentiation analysis: The one that considered fixed prices and a fixed number of firms and looked for the location equilibrium for

each number of firms (Eaton and Lipsey 1975) and the circular market with an endogenous number of firms (Salop 1979).

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Human Experimentation

Roberto Ippoliti
Department of Management, University of Turin, Turin, Italy
Scientific Promotion, Hospital of Alessandria – "SS. Antonio e Biagio e Cesare Arrigo", Alessandria, Italy

Abstract

Human experimentations refer to medical investigations with humans involved as experimental subjects. These trials are prospective researches aimed at answering specific questions about biomedical interventions, generating safety and efficacy data on drugs and treatments, innovative devices or novel vaccines, as well as new ways of using known interventions.

After a brief introduction of human experimentations, this section presents the main related issues in Law and Economics, i.e., the risk sharing between society and pharmaceutical industry.

Synonyms

Clinical trials; Medical experimentation

Definition

Human experimentation refers to a scientific investigation with humans involved as experimental subjects.

Clinical Research and its Organization

Human experimentations refer to medical investigations with humans involved as experimental subjects. These trials are prospective researches aimed at answering specific questions about biomedical interventions, generating safety and efficacy data on drugs and treatments, innovative devices or novel vaccines, as well as new ways of using known interventions. The investigation requires an ex-ante authorization by the competent Institutional Review Board (IRB), also called Ethic Committee in Europe, which is an independent authority designed to approve the experimental activity if an appropriate level of safety for the involved subjects is guaranteed.

According to a stylization elaborated by the US National Health Institute, the human experimentation can be classified as follows:

- Studies of phase I, researchers test an experimental treatment on a small group of healthy and voluntary subjects (20–80) in order to evaluate its safety, determine the dosage, and identify side effects.
- Studies of phase II, the experimental investigation is extended to a larger group of patients

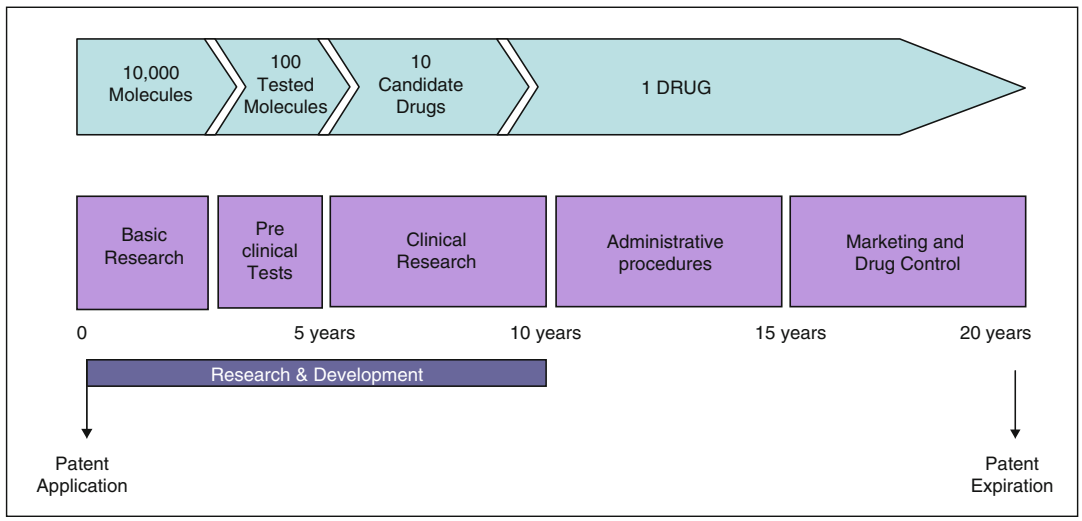
(100–300) to see whether it is effective and further evaluate the safety.
- Studies of phase III, the experimentation involves 1,000–3,000 individuals and it is directed to gather a more extended dataset of information concerning its effectiveness of the treatment, side effects, the comparison with already existing treatments, and many other details.

The classification is based on the development stage of the innovative product and/or treatment. At earlier stages, investigators enroll volunteers and/or patients into small (pilot) studies and then, if positive safety and efficacy data are collected, they conduct progressively larger-scale studies. This is exactly the main risk of human experimentation, i.e., the possibility of collecting high level of toxicity and negative efficacy data, raising the main Law and Economics issue which is related to the human experimentation: the risk sharing between society and pharmaceutical industry (Ippoliti 2013).

Pharmaceutical Research and Development (R&D) is a complex of activities aimed at discovering and developing new products to care patients. Generally, the pharmaceutical R&D can be stylized into two subsequent phases (Criscuolo 2005):

- The first stage, which is the basic research devoted to advance the current knowledge by designing new productive opportunities, i.e., new molecules, new compounds, or new techniques
- The second stage, which tries to make the previous discoveries workable by testing the innovative products on animals (i.e., preclinical test) and then on humans (i.e., clinical research or human experimentation)

The following figure summarizes the entire production process of the pharmaceutical company and, as it can be easily seen, the R&D process is the main productive activity with a deep economic investment. More precisely, clinical research is directed at collecting clinical evidence to obtain from the national regulatory agencies the authorization to market the innovative products. This step is mandatory in order to commercialize a drug and thus to make the investment profitable. However, as aforementioned, another opportunity to make the R&D activity easily profitable is risk sharing (Fig. 1).



Human Experimentation, Fig. 1 Production process of the pharmaceutical industry (Source: Les Entreprises du Médicament (LEEM Report 2008))

The sharing idea is linked to unexpected adverse events which companies and patients must face. According to Ippoliti (2013), in order to expand medical knowledge, not only does society need to accept companies' market power (monopoly) but also a part of the adverse risks linked to human experimentation. Only if patients accept to bear all expected adverse risks, signing the informed consent (The Association of the British Pharmaceutical Industry 1994), the opportunities to make the investment worthwhile will raise since the expected cost will decrease. The key role of this risk sharing is the informed consent, which might be viewed as a contract between research subjects and sponsor.

Cross-References

▶ Institutional Review Board

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