

Responses of Law and Economics to the Threat of Its Initial Success

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1. Introduction

The economic analysis of law succeeded more than even its most optimistic founders expected. Why? Lawyers lacked a scientific theory to predict the effects of sanctions upon behavior, developed from economics after 1960 (Cooter, 1995). In other words, lawyer–economists have succeeded in expanding the explanation of individual market behavior to the law by providing to the analysis of the law the seminal insight that people respond to incentives: ‘Just as markets charge prices for commodities, laws impose sanctions on acts’ (Korobkin & Ulen, 2000, p. 1055). In order to be able to study the legal implications of viewing law as a series of incentives, assumptions have to be made about the consequences of those incentives to the people subject to the legal system. To satisfy this need, lawyer–economists imported from *rational choice theory* the assumption that individuals maximize their preferences as efficiently as possible, given existing constraints. However, law and economics’ initial success has been under threat for some time now. Why is that? How has this threat been responded to? And how convincing are these responses? An important reason why law and economics is under threat is that empirical research has demonstrated that the functioning of the law cannot be well understood on the basis of the assumption of the rational actor and that policies based on this assumption are likely to be flawed. Since this criticism goes to the heart of law and economics, it has not gone unnoticed. Three responses can be distinguished. Whereas the first response maintains that the limitations attributed to the rational actor are grossly exaggerated and can easily be incorporated in rational choice theory, the second response welcomes the criticism and sees it as an opportunity to come up with an integrative theory of law and behavior. The third response also takes the criticism seriously but replaces the aspiration to come up with such an integrative theory with an approach that is sensitive to context-specific conceptions of rationality. It will be argued that the first two responses fall short, while the third response offers a promising way to go forward.

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The next section reviews the empirical research that challenges the assumption of the rational actor when it comes to law and behavior. Subsequently, the three responses to the critique on this assumption are discussed and evaluated. The paper ends with a summarizing conclusion.

2. Challenging the Assumption of the Rational Actor

2.1 *Types of Human Behavior*

A rapidly expanding body of foremost psychological empirical studies, which are often subsumed under the heading of behavioral law and economics, has criticized the assumption that individuals make rational decisions. In essence, behavioral law and economics is defined in opposition to the assumption of the rational actor: 'it is economics minus the assumption that people are rational maximizers of their satisfaction' (Posner, 1998, p. 1552). However, behavioral lawyer–economists continue to use rationality as their main point of reference. They commonly refer to 'bounded rationality', 'bounded will-power', and 'bounded self-interest'. This suggests, although bounded, that rationality is still the standard. In this sense, Kelman (1998, p. 1580) is right in stating that behavioral law and economics and rational choice theory stand together in 'irreconcilable mutual dependence', 'bound together in a form of rhetorical duet or ritualized dance'. This means that, on the one hand, the behavioral law and economics movement has criticized the assumption of the rational actor in legal analysis but, on the other hand, has treated other types of behavior as a residual category.

The typology of human behavior introduced by Max Weber (1925), one of the founding fathers of sociology, offers an escape from the limitations that are posed by sticking to the rational actor as the main point of reference. In his typology *instrumental rationality* is but one among several types of behavior. It pertains to behavior that focuses on optimizing the consequences or utility of individuals' decisions, in the sense of choosing the best option as judged by the agent (Elster, 2007, p. 193). This is also the type of behavior rational choice theory focuses on (Boudon, 1998, 2003). The other types concern traditional and affective behavior, and substantive rationality. *Affective behavior* is infused by emotion and enacted without premeditation. *Traditional behavior* originates from prevailing habits that are internalized to such an extent that an individual no longer realizes why she always performs the same actions under certain circumstances. As is the case with affective behavior, there is no premeditation about the potential consequences or utility of the act. *Substantive rationality* arises from the conviction that a certain action possesses intrinsic value ('Eigenwert'), independent of utility or result. Executing the act is the goal in itself. 'The captain who is convinced that he owes it to his honor to jump a sinking ship last, behaves substantively rational. When he would abuse his authority to be the first to enter a rescue boat, others would see him as a person without honor. And this knowledge would be unbearable' (De Jong, 1997, p. 116, translated from Dutch). Max Weber's typology provides a useful heuristic device to show that each of the other three types of behavior are

indispensable to understand the functioning of the law and that policy recommendations can be derived from these insights.

2.2 *Emotions*

There are scholars who have attempted to model the place of emotions in the law or have addressed the ‘appropriateness’ of various emotions for the substantive law (Blumenthal, 2005). In principle, emotions have no place in the concept of the rational decision maker. As far as emotions have been taken into account by rational choice scholars, they have implicitly or explicitly assumed ‘that emotional states are conscious and controllable, that people are aware of and can predict their emotions, and that as a partial result “people can cultivate their emotions”’ (Blumenthal, 2005, p. 161). Yet the assumptions that people are able to predict and control their emotions have both proven problematic.

As regards people’s capacity to predict their emotions, empirical research has shown that although people are relatively adept at knowing which emotions they will experience and whether they will be positive or negative, they are surprisingly inaccurate at predicting the intensity and the duration of those emotions. (Blumenthal, 2005, p. 167). For instance, through a process of ‘hedonic adaptation,’ victims of traumatic experiences are able to return to a more normal experience of emotion sooner than might be expected. This inability to accurately predict future emotional states may lead, for example, to overcompensation for noneconomic losses such as ‘pain and suffering,’ ‘mental anguish,’ or ‘loss of (or “lost”) enjoyment of life’ in a civil jury system if jurors consistently overpredict the degree of emotional distress a victim will suffer (Blumenthal, 2005, p. 183). Besides, research has demonstrated that people are limited in their ability to control their emotions. At sufficient levels of intensity, emotions can overwhelm cognitive processing altogether. ‘Under the influence of intense emotions, people often report themselves as being (or having been) “out of control” or “acting against their own self-interest”’ (Mitchell, 2002, n. 95). For example, anger or pride may lead to increased frequencies of trials, particularly when aroused by parties’ beliefs and expectations about the other party’s behavior, beliefs, and emotions (Blumenthal, 2005, p. 205). The consequence of this is more trials than would be predicted by the rational choice model, unless steps are taken to mitigate the parties’ evaluative biases.

Taking into account people’s limited abilities to predict and control emotions has two potential implications for legal policymakers. First, ‘one way to address some of the concerns related to the limited ability to predict emotions would be to admit expert evidence on affective forecasting research, as well as coping mechanisms more generally, during the damages phase of civil trials that involve damages for emotional distress’ (Blumenthal, 2005, p. 187). Second, the importance of emotions for subjects to the law provides support for alternative forms of dispute resolution, allowing litigants room to ventilate and deal with their own emotions and with the emotions of their opponents. This is congruent with the modern trend in civil litigation toward mandatory settlement conferences, court-ordered mediation, and nonbinding arbitration.

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2.3 Tradition

Traditional behavior is relevant for legal scholarship because it shows that past behaviors can affect current choices. The fact that past behavior often increases the likelihood that individuals will act in the same way in the future poses a problem for law and economics. After all, economists employing rational choice theory assume either that choices an actor has made in the past will not affect his current preference structure or that yesterday's choices will negatively affect today's choices, owing to the application of the concept of declining marginal utility (Korobkin & Ulen, 2000).¹

This positive effect of past choices on current ones can result, among others, from people's habit of simplifying their tasks by using rules of thumb, or heuristics. For example, judges reason by reference to past cases; jury judgments about damage awards are likely to be based on anchors, even arbitrary ones, such as the plaintiff demand; and people tend to think that events are more likely if an example is readily called to mind or 'available.' Consequently, media coverage of major incidents fuels demand for risk regulation (Jolls, Sunstein & Thaler, 1998ab). Reverting to earlier decisions can turn into traditional behavior when these decisions solidify into recurring decision patterns that are more or less taken for granted. The fact that lawyers—public defenders, prosecutors, judges—constantly decide about individual cases that are similar in many respects (Lipsky, 1980) gives them the opportunity to incorporate experiences with the consequences of prior decisions in current decisions (Gilboy, 1992). Such use of prior knowledge is accompanied by the normalization, standardization, and simplification of decision-making; in other words by the routinized use of mental shortcuts. In his classic study 'Normal Crimes', Sudnow (1965, p. 267) indeed shows that when a public defender 'puts questions to the defendant he is less concerned with recording nuances of the instant event [...], than with establishing its similarity with "events of this sort". That similarity is established, not by discovering statutorily relevant events of the present cases, but by locating the event in a sociologically constructed class of "such cases".' Likewise, criminal judges recognize and respond to the cues and expectations provided by decisions made earlier in the criminal process and predict decisions downstream (Tata & Hutton, 1998, p. 353). As a result, cases are not entirely evaluated on the basis of their own merits but are connected to regular behavioral patterns or with what is consciously or unconsciously conceived of as familiar and self-evident.

A broad implication for legal policy that can be derived from acknowledging the positive relationship between past and present behaviors is that policymakers should realize that traditional behavior is likely to be much more difficult to manipulate than rational choice theory would predict (Korobkin & Ulen, 2000, p. 1116).

1 But see Becker (1996 chapter 6), although Becker wrongly regards traditional behavior as instrumentally rational because the former is not premeditated, whereas the latter is (see Elster, 1986, p. 4).

2.4 *Substantive Rational Behavior*

A trite but nonetheless highly relevant finding for legal scholarship is that under certain conditions individuals subordinate their self-interest to compliance with social norms. Although compliance with social norms is not always easy to distinguish from traditional behavior, especially not when norms are widely shared and more or less taken for granted, most important for our argument is that the sacrifice of self-interest to compliance with social norms contradicts a version of rational choice theory that assumes individuals act selfishly (for other versions of rational choice theory, see Korobkin & Ulen, 2000, p. 1061).²

According to rational choice theory, the more the risks of being penalized for violating laws exceed the benefits of doing so, the more individuals are inclined to comply. In a review article, Robbenolt (2015) confirms that financial incentives influence the inclination to behave unethically, but she also concludes that individuals value their moral self-image and that this concern moderates other incentives for unethical behavior. 'Thus, even when there are financial incentives for deviant behavior and there is little or no chance of being caught, not everyone violates rules, and those who do tend only to do so a little bit' (Robbenolt, 2015, p. 81). Individuals look to others to figure out how to behave ethically, particularly in ambiguous circumstances. Furthermore, individuals are particularly inclined to mimic a peer's ethical behavior when the peer is a member of the individual's in-group or when there is otherwise a feeling of social closeness with that peer, or when the influence comes in the form of direction from an authority figure. In sum, there are many situations in which individuals act or abstain from acts because they deem this morally right or because they believe this is expected of them, independent of the utility or results of this behavior in terms of self-interest.

Korobkin and Ulen derive potential policy implications from the insight that individual behavior motivated by social norms differs from what would be in the actors' direct self-interest. First, policymakers can decide to employ law to violate inefficient or undesirable social norms, to support social norms, or to shape them. 'For example, by banning the selling of babies, the selling of bodily organs, or the selling of sex, the government might reinforce a social norm that neither the body nor its parts should be commodified' (Korobkin & Ulen, 2000, p. 1133). Second, lawmakers may fall back on the principle of noninterference by relying on norms to be self-enforcing, or by codifying the prevailing norms, thus supporting the prevailing norms with the enforcement power of the state.

2.5 *Conclusion*

While law and economics start from the assumption that individuals make instrumentally rational decisions, Max Weber's typology of human behavior can be used to classify empirical studies that have demonstrated that the functioning of the law cannot be understood well without taking into account the three other

2 As will be argued in Section 5, the rebuttal by rational choice theorists that norm-compliant or altruistic behavior can in fact be reduced to selfish behavior falls short.

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types of behavior. Even where law seeks directly to regulate economic relations, ‘other matters [than instrumental rationality, PM] are likely to be implicated: values and beliefs (for example, shaping understandings of and attitudes to economic activity and state regulation); practices and customs arising from working together in a common business environment; and emotional allegiances or rejections touching on business decisions (for example, regarding choices of clients or trading partners, or dealings in certain nations)’ (Cotterrell, 2017, p. 29/30). This failure to properly understand the functioning of the law based on the assumption of the rational actor has led to this assumption being questioned on empirical and normative grounds. Extending the premise of utility maximizing from the economic sphere of wealth creation in competitive markets of private goods to the law by using the analogy of conceiving legal instruments as incentives directing behavior has been criticized for lacking empirical realism and explanatory power (Zafirovski, 2018). As individuals often do not behave (only) as utility maximizers, the normative value of legal institutions that are designed on this premise has also been questioned (Somers, 1998). Ignoring systematic irrationality on the part of the executioners and subjects of these instruments will lead the designer to miscalculate the consequences of these instruments: ‘Why should institutions that would be best if everyone were rational recommend themselves to individuals who know that they themselves – the future inhabitants of those institutions – are less than fully rational?’ (Kornhauser, 2002, p. 33). Three responses can be distinguished to the critiques on the assumption of the rational actor. These responses vary in their implications for the rational choice theory that initially determined the success of law and economics.

3. Denouncing Behavioral Law and Economics

The proponents of the first response defend the claim that the limitations attributed to rational choice theory are grossly exaggerated. Their main argument is that the actions that appear to be noninstrumentally rational—tradition, emotion, and substantive rationality—are actually instrumental *at a deeper level* (Boudon, 1998, p. 818). This conversion from noninstrumental to instrumental is obtained by introducing the postulate that, contrary to appearances, actions are the product of self-interest. Richard Posner (1998), one of the founding fathers of law and economics, defends this position in an influential article from 1998. In this article, Posner conceives of emotional behavior as part of instrumental rationality rather than as an independent behavioral type. He argues ‘that preferences cannot be divorced from emotion, or emotion from their stimuli, and so instrumental reasoning cannot be thought pervaded with irrationality merely because a frequent goal of such reasoning is a preference that we would not have if we were not emotional beings’ (Posner, 1998). On the basis of this argument, he defends rational choice theory against the outcomes of so-called ‘ultimatum games.’ In ultimatum games, donors are given a money amount and are asked to allocate a share of the amount that they are given to their recipient. If the recipient accepts the share, then both donor and recipient go home with these respective

allocations, but if the recipient declines then both parties go home with nothing. The finding that recipients usually prefer to remain empty-handed rather than to accept a derisory offer questions the assumption of the rational actor. After all, for a rational actor, anything is better than nothing. Posner rebuts by arguing that refusing insultingly low offers can be interpreted in terms of a remnant of adaptive evolutionary behavior: '[i]nability to make a credible threat to retaliate renders a person virtually defenseless in a prelegal, prepolitical society' (Posner, 1998, p. 1562). Finding the courage to retaliate would require a state of emotional arousal. Allegedly, the emotions connected to the ingrained inclination to retaliate causes recipients to decline insultingly low offers in ultimatum games. What appears to be nonrational post hoc is to be viewed rational ex ante: [Thus] 'having an unshakable commitment to retaliate may be ex ante rational by lowering the risk of being a victim of aggression, even though, if the risk materializes, acting on the commitment will then (that is, ex post) become irrational' (Posner, 1998, p.1565).

In relation to traditional behavior, Posner argues that some critics still attribute to rational choice theory the assumption that individuals decide on the basis of complete information. However, he believes this assumption has long been aborted by rational choice theory. Precisely because collecting information is expensive, it is efficient to resort to rules of thumb. This explains why the fact that an actor acted in a certain way in the past often increases the likelihood that he will act in the same way in the future. As such, for example, the availability bias – the propensity to overestimate the relevance of salient or memorable incidents at the expense of the accurate prediction of the probability of future events – can be conceived of as a rational reduction of complexity and uncertainty. Absent other information, it is smart to trust in indirect signals such as the availability of salient or memorable incidents. For the same reason it is also rational to adjust one's own behavior to that of others. 'Habit-formation is [simply] one way in which "learning by doing" works; tasks are performed more quickly and with less effort when they become habitual' (Posner, 1998). In other words, traditional behavior is a means to make efficient choices and to reduce complexity and uncertainty.

Posner reduces substantive rational behavior to instrumental rationality by falling back on evolutionary biology again:

Inclusive fitness, defined as maximizing the number of copies of one's genes by maximizing the number of creatures carrying them, is greatly enhanced by his having a proclivity to help his relatives, and so it is plausible to suppose that this proclivity evolved as an adaptive mechanism. [...] Nowadays we interact a great deal with strangers. But our instincts are easily fooled when confronted with conditions to which human beings never had a chance to adapt biologically. [...] Voting, giving to charities, and refraining from littering, in circumstances in which there is neither visible reward for these cooperative behaviors nor visible sanctions for defection, may illustrate an instinctual, and as it were biologically mistaken, generalization of cooperation from small-group interactions, in which altruism is rewarded (hence

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reciprocal) and failures to reciprocate punished, to large-group interactions in which the prospects of reward and punishment are so slight that cooperation ceases to be rational. [...] We can see how bringing evolutionary biology into the picture enables the concept of rationality to be enlarged to cover phenomena [such as altruism and fairness] that [Jolls, Sunstein, and Thaler] classify as irrational (Posner, 1998, p. 1561).

4. Why Denouncing Behavioral Law and Economics Falls Short

In short, many findings put forward by behavioral law and economics with the aim of criticizing the assumed rational actor instead are treated as confirmations of the very same rational actor by Posner. Nonetheless, he realizes that doing so is risky when he writes: 'Of course, enriching the rational-choice model runs a risk of explaining nothing by explaining everything' (Posner, 1998, p. 1567). What he may mean by this is that 'enriching' rational choice theory implies that the concept of instrumental rationality is stretched to such an extent that it can no longer be distinguished from other types of behavior. Where does instrumental rationality start, and where do emotions, traditions, and substantive rationality end?

Furthermore, underlying Posner's argument is the assumption that the three other types of behavior merely support instrumental rationality. Remarkably, he altogether overlooks the possibility that the reverse may be true, without substantiating his ranking order anywhere. After all, it is more plausible to assume that emotions dominate rationality than to assume the reverse. What human beings reflect upon and think about is emotionally loaded. Neurophysiologically, all information first passes the emotional part of the brains and only subsequently, after being emotionally loaded, enters the parts of the brain that execute planning, mental imagination, etc. The connections from the emotion parts of the brain to the ratio parts of the brain are more extensive and faster than are the reverse connections (Weenink, 2009). Therefore, assuming that other types of behavior are secondary to instrumental rationality is based on nothing else than the wish to uphold instrumental rationality as the ultimate type of behavior (Jolls, Sunstein & Thaler, 1998b, p. 1593/4).

One way to refute this criticism of overstretching the concept of instrumental rationality is by treating reasons, by principle, as unknowable (Boudon, 1998, p. 819). On the basis of this positivist epistemology, researchers such as Posner postulate to rely only on observable human behavior, or what economists designate as revealed preferences (see also Schroeder, 2001). The only thing that matters is whether or not theories incorporating this postulate reproduce correctly in the observed data (Jolls, Sunstein & Thaler, 1998b, p. 1599). The reasons people give for their own actions are deemed as completely irrelevant.³

3 It is ironic that Friedman and Posner take a theory rooted in a radical individualistic philosophy and a desire to understand human behavior and purport to remove individual psychology from it (Schroeder, 2001).

For example, if a player in an ultimatum game indicates that the only reason for rejecting a derisory offer was pure indignation or the definite conviction that the offer was principally unfair, then Posner knows it was 'really' because she did not want to give the impression to her opponent she was weak. 'However, at this point, the rational choice theorist should explain the "false consciousness" she attributes to the actor' (Boudon, 1998, p. 819). Why does the subject think she acted out of emotion, habit, or conviction while she *really* did for instrumental reasons? Boudon (1998, p. 819) maintains that people's motivations for their behavior can be reconstructed. To this reconstruction he attributes the status of a theory that can be confronted with data. Boudon may be overly optimistic in assuming that the reconstruction of motivations can reveal the causes of behavior. After all, it has been firmly established that people have little or no direct introspective access to higher order cognitive processes such as 'thinking,' 'affective appraisal,' and 'action systems.' Rather, their reports on their cognitive processes, that is, on the processes mediating the effects of a stimulus on a response, are based on a priori, often culturally accepted implicit causal theories or judgments about the extent to which a particular stimulus is a plausible cause of a given response (Nisbett & DeCamp Wilson, 1977, p. 231). Still, when researchers rely exclusively on observable behavioral patterns they simply cannot know whether or not their interpretations of these patterns are congruent with the manner in which people interpret their own behavior (Fuhse, 2009), nor can they account for potential discrepancies.

A second problem connected to ignoring reasons motivating actions is that this renders it possible to define completely opposing behaviors as instrumentally rational. This problem is present, for example, in relation to behavioral studies showing people's leaning to attribute more importance to losses than to gains. Whereas Posner attributes loss aversion to a profitable evolutionary survival mechanism, there is a long tradition in economics of arguing that competition or evolution will drive out precisely those people who show loss aversions because they do not do what they are supposed to as rational actors. After all, standard reasoning in economics is that it is rational to ignore sunk costs, meaning that irreversible past actions should not influence current choices. This means both loss aversion and its absence can be interpreted in terms of adaptive evolutionary behavior. 'It is difficult to see what conclusions should be drawn from the fact that evolution can be shown to produce a behavior – loss aversion – and the absence of that behavior' (Jolls, Sunstein & Thaler, 1998b, p. 1600). In fact, resorting to revealed preferences makes rational choice theory incapable of generating predictions at all because whatever happens can be said to have been a result of the relevant utility function, constructed *ex post* (Arcuri, 2008; Schroeder, 2001). Such *post hoc* explanations do not help the policymaker who wants to know beforehand what is to be expected from legal instruments and who will not be interested in what an instrumentally rational actor would do, knowing such an actor does not exist in many situations (Korobkin & Ulen, 2000).

A third problem connected to the attempt to conceive of other types of behavior as instrumental rationality at a deeper level is that it requires auxiliary assumptions to do so. Posner argues that altruistic behavior that does not serve a foreseeable

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self-interest is to be seen as a residual of biological instincts once needed to pass on one's own genes and reproduce. Nowhere does Posner substantiate the claim that misguided instincts steer our behavior. Not even does he clarify how this claim can be tested at all (Jolls, Sunstein & Thaler, 1998b). On top of that, it is superfluous to make this additional claim; 'a behavioral approach to the economic analysis of law can proceed whether or not the evolutionary account is right' (Jolls, Sunstein & Thaler, 1998, p. 1600). What is also problematic is that the hypothesis that dysfunctional instincts continue to steer behavior contradicts Posner's own optimism 'that people can be cured of some of the cognitive quirks and weakness of will with biological roots' (Posner, 1998, p. 1575). After all, if people can unlearn behavior that prevents them from acting rationally with no offsetting gains, why then do they continue to show it when it comes to altruism or fairness? In short, the assumption of the rational actor underlying rational choice theory can be upheld only by stretching the concept of instrumental rationality so far that it can no longer be distinguished from other types of behavior, by ignoring reasons motivating people's behavior, and by using post hoc explanations or by introducing auxiliary assumptions. As such, a response that denounces behavioral law's criticism on the assumption of the rational actor is problematic.

5. Welcoming Behavioral Law and Economics

There are other lawyer–economists who welcome behavioral law and economics, by taking the limitations of the rational actor seriously. This welcoming approach focuses on the finding that individuals sometimes obey social norms that are contrary to their direct self-interests (for example, Cooter, 1995; Ellickson, 1989; Rostain, 2000). Representatives of this position deem attempts insufficient to interpret such behavior in terms of instrumental rationality at a deeper level.

One can argue that people voluntarily comply with social norms because they want to avoid informal sanctions and because they expect to be rewarded with esteem and recognition if they do so. However, subsequently, this argument raises the question as to why individuals care to make the effort to punish deviance even though punishing can be costly (Rostain, 2000). After all, it can lead to retaliation by the sanction's target. Again, one could argue that individuals are prepared to sanction because they may expect a reward for doing so. However, logically one ends up at the question of why this precise behavior is rewarded, rather than, for example, encouraging the violation of a social norm:

Even if the motivation to sanction a norm violator might be explained by external incentives – people think highly of people who informally sanction others for violating norms – the motivation for expressing such approval cannot, in turn, be reduced to external incentives. The collective action problem, solved on the level of primary norm enforcement, reemerges at the next level, or, if solved on the secondary level, at the next level after that (Rostain, 2000, p. 992).

According to Cooter (1995), this conundrum cannot be solved by conceiving preferences as given, as is customary in rational choice theory. Preferences themselves require explanation. Supposedly, individuals may choose to act unselfishly, because of who they want to be. By internalizing values connected to impersonal roles, the gap between the self-interest of the agent and the interest of the principal reduces, rendering external control superfluous. Internalizing makes sure someone adopts shared norms to such an extent that it becomes part of one's self-image. When that happens, a distinction arises between two types of self-interest. A thin version looks only to objective payoffs in wealth or power. A thick version modifies objective payoffs to encompass the subjective value of morality. When actors decide on the basis of a thick self, the cost of violating social norms is not loss of esteem in the eyes of peers but guilt or shame for doing something the actor experiences as 'wrong.' The costs of violating social norms are imposed not by society but by the violator herself.

6. Why Welcoming Behavioral Law and Economics Is Incompatible with an Integrative Theory of Social Behavior

Cooter and others do not believe that distinguishing between a thin and a thick self, or between egoism and altruism, has huge consequences for rational choice theory. Supposedly, incremental adaptations inside the rational actor paradigm suffice. What is more, incorporating the conceptions of a thick self and of altruism in rational choice theory would even hold the prospect of developing a general theory of social behavior (Cooter, 1995; Ellickson, 1989). However, the more fundamental the distinction between these types of behaviors is, the more problematic it becomes, first, to assume that it is instrumental rationality that steers individual behavior. After all, acknowledging the existence of a thick self and of altruism implies that substantive rationality can also steer individuals' behavior. Second, acknowledging the existence of these types of behavior raises the question as to the conditions under which the thin or the thick self, or egoism or altruism prevails (see also Elster, 1986, p. 24). Precisely because rational choice theory starts from the assumption of the rational actor, this crucial question cannot be raised in this paradigm (see also Schroeder, 2001). In other words, the more fundamental the distinction between instrumental rationality and substantive rationality is, the more fundamentally the rational choice paradigm is challenged. Cooter himself, in fact, already recognizes that the distinction between a thin and a thick self is crucial, by admitting both selves can be incompatible. A study by Lindenbergh and Mascini (2013) can be used to illustrate that the two selves can indeed be incompatible. They have studied how victims of personal injuries attempt to satisfy their concomitant need for financial compensation and restoration of a harmed relationship with the injurer. The attempt to fulfill both needs confronts victims with a double dilemma: on the one hand, a calculative attitude of the victim increases the chance of receiving a good financial compensation but hampers reconciliation with the injurer. On the other hand, forgiveness promotes restoration of the distorted relationship with the injurer but involves the risk of

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an injurer deploying excuses and admission of guilt in an attempt to lower damages. This double dilemma generates a game situation in which both the weighing of the self-interest and the mutual interest by the victim and the weighing of both types of interests attributed to the injurer may vary. 'Once we recognize social interactions as potentially exhibiting a variety of game structures, we must acknowledge that a mix of motives operates in human behavior, including cooperation, altruism, and self-interest' (Rostain, 2000, p. 999-1000).

This theoretical matter also has implications for policy making. Perhaps the most important implication is that laws that try to offset the inherent utility of non-compliant behavior with corresponding costs may crowd out substantive rational behavior. Studies have shown, for example, that people are more inclined to comply with environmental rules when *no* sanctions are attached to rule violations than when there is the prospect of a small sanction (Tenbrunsel & Messick, 1999); the introduction of small fines for the delay in collecting children from school actually produces more, not less, in the way of lateness (Gneezy & Rustichini, 2000); and people accept the presence of nuclear waste on their city's land more easily when they are *not* offered compensation than when they are (Frey, 1997). What explains these findings is that the presence of a system of rewards and punishments signals that individuals are expected to make a cost-benefit analysis, while the absence of such incentives appeals to moral and ethical reasoning. This shows that the motivations of actors within institutions are dependent on the chosen institutions. Put differently, a motivational assumption may be self-fulfilling (Kornhauser, 2002, p. 37/8). Consequently, it can be counterproductive to design legal instruments on the basis of the assumption that individuals will defect as it may crowd out cooperation.⁴

In short, lawyer-economists whom welcome behavioral law and economics wrongfully assume that distinguishing between a thin and a thick self, or between egoism and altruism or interest/utile and good/justice, can easily be reconciled with rational choice theory. These distinctions imply that substantial rationality and instrumental rationality have to be taken equally seriously as guiding principles of behavior. Consequently, instrumental rationality can no longer be used as the sole point of reference, particularly not since it is acknowledged that both types of rationality can be incompatible. Moreover, acknowledging that legal instruments may alter the preferences that an individual actually has automatically implies

4 As rightfully pointed out by one referee, under certain conditions it can obviously also be counterproductive to design legal instruments that are based on the assumption that individuals behave substantially rationally. At large-scale cooperation in anonymous groups with large potential gains from opportunism and free-riding, it is indeed risky to invoke and rely on voluntary cooperation/compliance. My main argument is precisely that it is important to use as a starting point of policy making that behavior can be driven by different motives that cannot be reduced to a common denominator (see also Kornhauser, 2002, p. 41 and Dagan, Kreitner, & Kricheli-Katz, 2018, footnote 16). Besides, focusing on opportunism and free-riding as the most important collective action problems rather than, for instance, on the process of acquiring sufficient resources from a certain number of actors from a specific population to achieve critical mass that successfully moves forward collective action (Brechin, 2016) by itself demonstrates a leaning toward a rational choice perspective as it centers on selfish behavior.

that the stability of preferences can no longer be taken for granted. In other words, recognizing the importance of these distinctions automatically implies that two pillars underlying rational choice theory – assuming instrumental rationality and stable preferences – fail. Consequently, the hope that rational choice theory can come up with an integrative theory of social action disappears beyond the horizon. As rightfully acknowledged by Ostrom (2010, p. 664), this lack of universality of rational choice theory is due to the fact that humans have a more complex motivational structure and more capability to solve social dilemmas than it assumes. Rational choice's universal claim of utility maximizing individuals is thus to be viewed as yet another chimerical attempt at the universal explanation of all phenomena by a single law (Comte, 1983). In sum, also the second response to the attack on the assumption of the rational actor is less than convincing.

7. Transcending Behavioral Law and Economics

The conclusion of the previous section is that refuting the idea that preferences are stable and fixed is incompatible with the aspiration of coming up with an integrative theory of law and behavior. The third response to the problematization of the assumption of the rational actor picks up at the endogeneity of preferences, while pleading for an approach that is sensitive to context. Its starting point is that preferences are unstable, incoherent, and dependent on context. It is propagated by the economists Hoff and Stiglitz (2016) and is yet to diffuse to law and economics.

They argue that whereas in early work in behavioral economics 'the concept of the decision-maker is the *quasi-rational actor* influenced by the context of the moment of decision, in some recent work of behavioral economics, the decision maker could be called the *enculturated actor*' (Hoff & Stiglitz, 2016, p. 25). Based on both natural and laboratory experiments, this latter work has demonstrated that culture and social context shape how individuals perceive the world, the lens through which they see it, and the categories they use to understand and interpret it and that these cultural schemata subsequently help constitute the social context from which the schemata emanate in the first place. In order to illustrate this mutual interaction between social organization and cultural schemata, they refer, for example, to a comparative study of Chinese rice farmers and wheat farmers. For their production, rice farmers are more dependent on collaboration with other farmers than wheat farmers are on collaboration with other farmers. These differences in social organization are reflected in the manner in which these farmers conceptualize the world and interact. Differences in conceptualizing the world are manifested by the fact that rice farmers are more likely to emphasize the holistic relationship between carrots and rabbits, while wheat farmers are more inclined to mention the analytical similarity between rabbits and dogs. A difference in interaction is exemplified by the fact that the rice provinces had a 50% lower divorce rate than the wheat provinces in China in 1996.

Hoff and Stiglitz (2016) also refer to a number of studies showing that changes in social conditions may also change the cultural schemata on the basis of which

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people make choices. For example, introducing emancipatory policies in patriarchal settings such as enrollment of women in savings groups and reserving leadership positions for women was shown to not only break down long-standing gender barriers but also to change men's and women's idea of what it means to be a woman. On the basis of these studies, Hoff and Stiglitz conclude that rather than the 'objective' circumstances, it is the perception thereof that determines people's choices. This implies that identical social circumstances can have multiple equilibria that are culturally determined and allow different policy interventions: 'If there is some way to change perceptions, we can change behavior – and possibly the equilibrium – without doing much else' (Hoff & Stiglitz, 2016, p. 40).

This third response deviates in two fundamental respects from rational choice theory: first, whereas rational choice theory tends to focus on 'objectively' observable behavior, or revealed preferences, in an attempt to avoid having to deal with the interpretation of how people give meaning to their behavior and social surround, the perspective of the enculturated rational actor uses meaningful behavior as its starting point of understanding behavioral patterns. Second, whereas rational choice theory tries to come up with predictions that are derived from the universally applicable assumption of individuals as maximizers of preferences, the third response assumes that individuals' conceptions of rationality shape and are shaped by their social and cultural context.⁵ These two fundamental deviations from rational choice theory also have normative implications for policy making and research.

In case there are multiple utility functions each of which can change as a result of policy, then the choice between utility functions goes beyond the instrumental view of economic policy and enters a normative debate about conceptions of the good society.

Assume, for instance, that there were a social evolution that led to an equilibrium in which our selfish self, rather than our other-regarding self, was the only one that manifested itself. Could we be non-judgmental about the desirability of such an equilibrium in comparison with one that was more balanced? (Hoff & Stiglitz, 2016, p. 51).

The normative implications for research concern the conceptualization of rationality and the role of the researcher. The early work of behavioral law and economics

- 5 Obviously, the two starting points of the enculturated actor approach are commonplace in other social sciences such as sociology and anthropology. For example, the first starting point closely aligns with Thomas' well-known sociological theorem 'If men define situations as real, they are real in their consequences,' while anthropologists are particularly sensitive to the importance of context and the role of researchers' background and identity. The problem is rather that rational choice theorists have mostly ignored other disciplines in the belief that economics is the 'queen' of the social sciences, thereby depreciating and invading different social sciences as inferior versus economics. By doing so, contemporary rational choice theorists evidently neglect the history of other social sciences (Zafirovski, 2018). Hoff and Stiglitz realize that adopting these two starting points unavoidably brings law and economics closer to the other social sciences.

has focused primarily on documenting whether and how heuristics fall short of some correct or optimal answer (Bruch & Feinberg, 2017). This suggests rationality can be measured against a universally applicable standard. The recent work on the encultured actor, by contrast, typically shows there is often no such thing as a universal metric for the optimality of decisions, since what is meant by that is culturally determined. Rather than more or less biased according to some universal standard, decisions are culturally more or less acceptable. Therefore, by branching into decision domains in which the quality or optimality of outcomes cannot be easily quantified (or in some cases even coherently conceptualized), the distinction between rational and nonrational decisions becomes less obvious. Heuristics or choices that are biased from the perspective of the researcher may, in fact, be situationally rational in light of the social circumstances in which the decision maker is embedded (Hawkins, 2001). In other words, the conclusion about the boundedness of rationality may, in fact, be due to a lack of the researchers' understanding of the context in which the decision maker is embedded. Therefore, '[t]he behavioral researcher is well advised to look carefully at his or her research participant's behavior, beliefs, and goals to discern "the method in the apparent madness"' (Mitchell, 2002, n. 121).

This also implies that it can be important to take into consideration the cultural background of the researcher. Empirical research cannot provide incontestable or simple answers about legal rationality for prescriptive use: 'ultimately, the choice of behavioral assumptions to guide policy will depend to some extent on value preferences and unrealistic or untestable assumptions about human nature' (Mitchell, 2002, p. 76/7, see also Cserne, 2017, p. 322). Posner is also aware of the potential importance of researchers' cultural and political orientations when he argues that underlying behavioral law and economics is

the implicit *liberal* conception of the average person – good, but inept, and for both reasons not very responsive to incentives, though perhaps rather plastic. The implicit *conservative* view of the average person, in contrast, is that he is competent but bad; hence conservatives emphasize incentives and constraints (Posner, 1998, p. 1559).

These beliefs held by the researcher may also affect their findings. After all, it has been established that particularly on ideologically and politically charged topics individuals tend to persist in their beliefs in the face of mounting evidence to the contrary, no matter what their level of numeracy is (Kahan et al., 2013).

To summarize, the concept of the decision maker as enculturated actor is far removed from the assumption of the decision maker as rational actor. Rather, it assumes that preferences are flexible, incoherent, and embedded in a social and cultural context. Since researchers are part of this context, their cultural background may reflect the evaluation of behavior as more or less rational. The idea that the study of the social and cultural context falls outside the scope of economics is viewed as a social construction in this third response to the attack on the assumption of the rational actor (Bruch & Feinberg, 2017; Hoff & Stiglitz, 2016).

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Although this perspective has yet to diffuse to law and economics, it would force lawyer–economists to open up, expand, and stretch even more than has the early behavioral law’s empirically founded criticism on the assumption that individuals act rationally. This third response cannot only accommodate the empirically founded criticism on the assumption of the rational actor, but also offers law and economics an opportunity to rise like a phoenix from the ashes.

8. Conclusion

One important reason determining the initial success of law and economics was that it provided predictions on how legal sanctions affect behavior, based on rational choice theory. In the beginning of the 1950s, Milton Friedman was able to cast aside early criticism on the assumption of the rational actor by arguing that ‘the relevant question to ask about the “assumptions” of a theory is not whether they are descriptively “realistic,” for they never are, but whether [...] they yield sufficiently accurate predictions’ (Friedman, 1953, p. 14). As empirical evidence piled up that challenged precisely the accuracy of the predictions derived from rational choice theory on how legal sanctions affect behavior, it became more difficult for lawyer–economists to ignore the criticism on the assumption of the rational actor. Richard Thaler (1992, p. 198), one of the fathers of behavioral economics, therefore raised the rhetorical question: ‘would you rather be elegant and precisely wrong, or messy and vaguely right?’

This paper has discussed three responses to the criticism of the concept of the decision maker as rational actor. The implications for rational choice theory increase with each of the responses. Whereas the first response maintains that the limitations attributed to the rational actor are grossly exaggerated and can easily be incorporated in rational choice theory, the second response welcomes the criticism and sees it as an opportunity to come up with an integrative theory of law and behavior. The third response also takes the criticism seriously but replaces the aspiration to come up with such an integrative theory with an approach that is context sensitive and allows for utility functions that are not based on instrumental rationality.

Moreover, it has been argued that the first two responses fall short, while the third response offers a promising way to go forward. Defending the assumption of the rational actor is deemed problematic because it can only be saved by stretching the concept of instrumental rationality so far that it can no longer be distinguished from other types of behavior, by ignoring the reasons people give for their own actions, by using post hoc explanations, or by adopting auxiliary assumptions. Combining a welcoming response with the ambition to come up with a universal theory of law and behavior is also viewed as problematic because it is incompatible with accepting the evidence that preferences can be based on potentially conflicting types of behavior, which are also changeable. After all, this means it can no longer be assumed that it is instrumental rationality that steers behavior and that preferences are stable. It also implies that policies based on the assumption of instrumentally rational actors can be counterproductive. The third

response is argued to be compatible with the empirically founded criticism on the assumed rational actor, because it takes into account that preferences can be based on different types of behavior allowing for multiple equilibria. Moreover, these preferences are viewed as conditional by social circumstances. Therefore, it also acknowledges that the assumption of the decision maker as a rational actor involves a political choice that excludes opting for policies that are based on alternative assumptions about decision makers. However, this last response has yet to be adopted by law and economics. Let us hope it will be.

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