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# UNIVERSITÀ DEGLI STUDI DI TORINO

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**Formal and Informal Norms: Their Relationships in Society and in the Economic Sphere**

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# Formal and Informal Norms: Their Relationships in Society and in the Economic Sphere

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**Abstract.** The thesis put forward in this paper is that in social life in general, and in the economic sphere in particular, the relationships between formal norms and informal social norms can be interpreted in terms of either reciprocal complementarity or conflict. The concept of complementarity illustrates how the two kinds of norm cooperate with and reinforce each other, and describes under what circumstances formal norms can or cannot replace informal rules. Conversely, the notion of conflict between different kinds of norms distinguishes two forms of antagonism: prohibition (which occurs when one type of norm **prohibits enforcement** of the other), and mutual exclusiveness (which occurs when one type of norm crowds out the other, without this entailing prohibition).

**Keywords:** formal norms, legal norms, informal social norms, complementarity, conflict.

**JEL Classification:** A12 ; A13; B40

## 1. Introduction

Informal social norms are pervasive components of social life which contribute together with formal rules to the shaping of human relationships. As a consequence, an analysis of the relationships between these two types of norm is fundamental for any understanding of how social systems function. It is probably for this reason that such relationships are investigated in many disciplines. Douglass North, whose approach has influenced numerous studies in economics and political science, showed that they are essential for understanding institutional change; the Austrian School examined them to explain spontaneous orders. Legal scholars – especially in the 1990s – have pointed out that patterns of behaviour

can be induced by altering not only the law but also customs and habits; experimental and behavioural economics, as well as economic psychology, have shown how social norms based on fairness and reciprocity cooperate with the market's formal **norms to determine** the outcome of individual performances. Although these approaches shed light on many aspects of formal and social norms, none of them has provided a comprehensive theory.

This paper starts from this fragmentation, and from the fact that a satisfactory theory about the relationships between formal and informal norms is still lacking. It tries to fill this gap by proposing a new perspective on these phenomena, and by suggesting a unified framework in which to arrange the many recommendations and intuitions deriving from other approaches. In particular, it examines two dimensions of the interrelations between formal and informal social norms: one, more general in character, considers how social and legal norms interact in various circumstances of private and public life; the other, more specific, examines how the relationships between formal and informal norms take shape in the economic sphere.

By 'informal social norms' (or more briefly social norms) I mean rules that are not promulgated by a legal authority and which regularly influence behaviours. They are based on socially shared beliefs (such as customs, traditions, and codes of behaviour) about what people ought to do, and they involve social or moral sanctions (see, R. Posner, 1997, p. 365; Fehr and Gächter, 2000, p. 166; Dequech, 2009, p. 72). Social norms are informal, since they are enforced "by the approval or disapproval of other people in the group or community", while legal norms (that is a significant class of formal norms) are "ultimately enforced by the organizations of the legal system" (Dequech, 2009, p. 72). This implies that the two kinds of norms are describable as non-legal (i.e. not expressed in law) and legal norms, respectively (Hodgson, 2006, pp. 11 and 13).

In short, social norms are informal and are not made explicit by written law (therefore, they can be labelled 'informal social norms'), while legal norms are formal and are expressed by law. For these reasons, and for the sake of brevity, in what follows the pairs of terms 'legal norms/social norms' and 'formal norms/informal norms' will be generally – but not always – used interchangeably. However, it should be pointed out that the concept of 'formal' is broader than that of 'legal'. As its stem reveals, the adjective 'formal' indicates something which has a defined shape; and when **it refers** to norms, it evokes a general class – one that is not simply reducible to law – which exhibits this connotation. Some norms of organizations, such as firms, administrative systems, bureaucracies etc., have formal, definite, features (such as directives which convey commands or **procedures**) **but** are not legal prescriptions. By contrast, the term 'informal' means: "Not done or made according to a regular or prescribed form" (Onions, 1973, p. 1069). From this perspective, the opposition between formal and informal norms can be interpreted in terms of a distinction between rules whose boundaries are well delineated and norms whose boundaries

are not. Used in this sense, the expression 'formal norm' will be adopted instead of 'legal norm' when this latter expression – because of its too specific meaning – is inadequate to capture certain phenomena.<sup>1</sup>

Formal-legal and informal norms can be conceived as alternative rules which govern social interaction, in that they work as different mechanisms of social coordination. Given this premise, the thesis put forward here is that the relationships between legal and social norms can be interpreted in terms of either reciprocal complementarity or conflict, and that in the economic sphere relations between formal norms (like those which regulate exchanges and contracts, whose enforcement is ultimately guaranteed by legal institutions) and informal social norms can be evaluated by adopting the same scheme.

By 'relationships of complementarity' I mean situations in which formal and informal norms cooperate with and even reinforce each other: **for example**, when a legal and a social norm jointly contribute to suggesting or preventing a certain behaviour. Cooperation within the same behavioural area sometimes indicates the fact that one norm might incorporate one of the functions of the other. In this case, the legal norm progressively formalises issues originally suggested only by the social norm, replacing one of its particular functions.<sup>2</sup> Yet replacement or, we may say, 'erosion' is not always possible, as in the case of shared moral judgements which cooperate with law but cannot be eradicated by it. This situation also characterises social conventions (such as norms of kindness, politeness, appropriateness of behaviour etc.), which are complied with because other people follow them, although they are to some **extent** arbitrary. Their function is to support the social order, and they are not replaceable with legal norms. In short, the replaceability or non-replaceability of one norm with another is the criterion used to distinguish two types of complementarity, which I call C1 and C2.

**With** the expression 'relationships of conflict' I refer to circumstances in which formal and informal norms are not compatible: that is, situations in which adoption of one type of rule impedes **compliance with** the other. In some cases, the conflict is radical, and one kind of rule explicitly prohibits the enforcement of the other, as when the law bans codes of revenge or seeks to suppress illegal markets. Yet the relationship of conflict also exhibits a less radical dimension, which entails that one kind of norm crowds out the other: paying the parents of your girlfriend when they have invited you for dinner is not prohibited; nonetheless, the norm regulating formal economic exchange - based on monetary payment - is incompatible with the social norm. In this circumstance, the mutual exclusiveness of norms can be described in terms of 'either this type of norm or the other', but it does not involve prohibition. Therefore, 'prohibition' and 'mutual exclusiveness' constitute the criteria by which relations of conflict are evaluated.

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<sup>1</sup> By recombining the two pairs of concepts (formal/informal norms and legal/non-legal norms), it can be argued that formal/non-legal norms govern diverse organizations. But this topic is not dealt with in this essay.

<sup>2</sup> For example, both the highway code and social norms cooperate when they suggest driving safely, and prescribe the same prudent behaviour: the use of seatbelts. But until the **1970s** in many countries such behaviour was regulated only by a social norm, and only later became a legal prescription.

The notions of complementarity and conflict occasionally appear in the current literature, and only rarely are their various meanings analysed systematically. I employ these terms because:

- i) starting from observable phenomena, they clarify that the relationships between formal and informal norms may fundamentally be viewed as opposing terms. The notion of *complementarity* shows that formal and informal norms work in the same direction, because they reinforce each other (and such reinforcement may culminate in the legal formalization of a social norm); while the notion of *conflict* emphasises that the two kinds of norm, being antagonistic, work in opposite directions;
- ii) they create a common ground able to connect different approaches, which range from economics to legal studies and from sociology to economic psychology.

These approaches, implicitly or logically, involve complementarity and conflict, but they do not provide any theories based on those concepts. In other words, **by using** the notions of complementarity and conflict this paper intends: 1) to provide a new **view on** the relationships between formal and social norms; 2) to show the connections between some of the results of the approaches taken by different disciplines, even when these do not directly refer to the notions under discussion; 3) to furnish a unitary and more general framework able **to fill the** gaps in other interpretations which consider only partial – though important – dimensions of the problem. Consequently, **clarification** of the relevance of the two criteria (the two subsets of complementarity and conflict) is the theoretical step that precedes the ensuing classification. Finally, the view of social and formal norms (and of their relationships) proposed **in what follows** implies a conception according to which the individual is socially embedded in these norms as well as being institutionalised and governed by them. This entails that individuals and socio-institutional structures influence each other. The notions of complementarity and conflict emphasise these aspects and show that behaviours, although engendered by individuals, also depend on how norms relate to each other. A behaviour inspired by a social norm, for example, is explained not only **with** reference to this kind of norm, but also **with** reference to the attitude that it expresses towards a formal norm (depending on whether it is considered as the complement or antagonist of the social norm). Some approaches which illustrate the relationships between norms do not always adopt this perspective; **and they** sometimes refer to variants of methodological individualism. The idea put forward in this paper is that some of these analytical outcomes can be reformulated in light of the above-outlined framework.

The paper is organized as follows: Section 2 introduces the literature which has dealt with relationships between formal and informal norms and has drawn up classifications by explicitly or implicitly considering the notions of complementarity and conflict; Section 3 examines how the relationships of complementarity and conflict can be reformulated, and focuses on legal and social norms. In particular, subsections 3.1 and 3.2 analyse complementarities of type C1 and C2; while subsection 3.3 considers relationships of conflict in

terms of both prohibition and mutual exclusiveness. Subsection 3.4 maintains that the boundaries between the two kinds of norm are **mobile**. Section 4 presents the analysis of formal rules and informal social norms in the economic domain, and subsections 4.1 and 4.2, respectively, discuss how complementarity and conflict emerge within this sphere. Finally, Section 5 **draws** conclusions.

## 2. Complementarity and conflict: perspectives and classifications.

In recent times, two authors have strongly oriented the debate on norms: F.A. Hayek and D.C. North (Chavance 2008, p. 59). Although Hayek does not use the terms ‘formal’ and ‘informal norms’, **they** play a role in his evolutionary theory. In his approach, primitive communities were **initially** regulated by social norms, traditions, customs, habits etc., and only later adopted a legal structure which replaced the original informal norms in some **domains**. The competition between different group rules determined the adoption of more advantageous norms, and led to the consequent decline of less advantageous alternative rules. This process coincides with the formation of spontaneous orders as a selection of abstract rules: **that** is, purpose-independent **rules which** apply to an indefinite number of instances. Law also takes shape through evolution as the articulation and systematisation of previously existing practices and norms (Hayek, 1973 pp. 85 and 100). If no external intervention modifies this process, law preserves abstract rules based on traditions without imposing any particular order (Hayek, 1960, chap. 10), and implements **spontaneous order, also by removing certain impasses that spontaneous order is not able to overcome with its own force (Hayek 1973, p. 88)**. This perspective entails that formal-legal rules are beneficial only if they are coherent with underlying informal norms and practices, and that the process of formation of spontaneous order is characterised by a fundamental continuity between formal and social norms. When society is fallaciously conceived as an “organization” that must be rationally planned, formal rules – which assume the form of “commands” **rather than** abstract general rules – become separated from customs and traditions. This destroys spontaneous order as the experience of socialism, according to Hayek, has shown (Hayek, 1973; 1978).

Although it is not central to his analysis, Hayek offers an interpretation of relationships between formal and informal norms. This theory, according to which law represents the evolution of certain social norms (Hayek, 1973, p. 78), conveys the idea that social norms can be replaced by formal norms as a consequence of a certain complementarity (see sub-section 3.1). However, Hayek clarifies neither what condition enables formal norms to replace social rules nor why some social norms are eroded, while others are not, but rather persist and reinforce formal norms. Essentially, these questions remain **unanswered because**

Hayek does not provide a clear definition of informal norms. In spontaneous order, law is seen as an extension of customs (Hodgson, 2009), and this prevents Hayek from distinguishing **between** the specific 'ways of working' of the two systems of **norms as** structures of social coordination. Ultimately, however, he does not examine the various forms of conflict between formal and social norms, except those in some way related to the notion of constructivism, which implies that law does not work in continuity with customs and with social rules that have emerged spontaneously over time. This particular idea of conflict does not consider the fact that law often tries to repress certain customs, even when no constructivist force is at work. Law and customs can be the outcomes of the same spontaneous processes and nonetheless be in opposition **because** they prescribe alternative behaviours (see sub-sections 3.3, 3.4 and 4.2).

Formal constraints (e.g., regulations, laws, statutes, constitutions) and informal constraints (e.g., social norms, conventions, self-imposed codes of conduct) play a fundamental role in Douglass North's new institutionalism, an approach which has influenced economics, sociology and political science. According to North, formal and informal constraints are the two components of institutions, and the varying ways in which they interact determine how societies change **over** time. From a historical perspective, informal constraints precede and condition the subsequent development of formal constraints. Their difference "is one of degree", and this implies a continuous and "unidirectional" move "from unwritten traditions and customs to written laws" (North 1990, p. 46). The transition from customs to laws delineates the idea that formal norms replace informal norms over time, but this concept, as in the case of Hayek, is not developed, and North does not explain why certain informal norms are replaced, while others persist and cooperate with their formal counterparts. However, North alludes to complementarity when he argues that "Formal rules can complement and increase the effectiveness of informal constraints" (1990, pp. 46). This happens both when an institutional system invests in "**piracy**" and when it supports productive activities (North 1990, pp. 77-78). However, complementarity, although expressed in this form, is not theoretically analysed nor is it included in a general theory.

The notion of conflict between different kinds of norms is not dealt with, except in a particular case. Social norms, and in general "cultural heritage", change slowly, and this is the origin of institutional path dependence. "[I]nformal constraints change at a different rate than formal rules" (North 1990, 87), and this can engender a conflict between the two kinds of norm, since reforms and revolutions can rapidly change formal institutions, while customs evolve gradually. A discontinuity of this type characterises situations in which formal rules that have developed in one country are imposed on another community, thus triggering tension with its informal norms (North 1990, pp. 101-103). **Also in this case, as in that of complementarity**, North does not provide a conceptual definition of conflict. This notion, rather than being defined in theoretical terms, is described in relation to cases that show the heterogeneity between formal and informal norms due to inappropriate institutional designs.



Some scholars have proposed typologies of relationships between formal and informal norms. In many respects, their intent is more descriptive than analytical, since for the most part they do not discuss theoretical criteria which explain the relationships between the two kinds of norms, and **they usually** present only schemes in which to include empirical cases. Nee (1998, p. 85) recognises the need to have “a theory of the nature of relationships between formal and informal constraints” that might explain variations in institutional performance, and he maintains that the two kinds of norm can be *congruent* (when they reciprocally reinforce each other, and for this reason are closely coupled), *decoupled* (when informal norms become separated from formal rules which have ceremonial characteristics), or *opposed* (when individuals organise economic activities, as has occurred in socialist systems, where people have organised a parallel, illegal, “second economy”). But Nee does not discuss in detail the criteria on which his classification is built. Therefore, although his typology describes relevant cases, it does not provide sufficient suggestions about the logic determining the relationships between formal and informal norms. The concepts of “close coupling” and “oppositions norms” could be developed to investigate the basic relationships between kinds of norms; but the former is not analytically dealt with, and the latter is confined to cases in which “institutions and organizational sanctions are weak relative to contradicting group interests” (Nee 1998, p. 88). The range of the possible dimensions of conflict between rules is consequently not examined. Moreover, the notion of “decoupling” seems essentially able to describe only specific organizational structures.

The New Institutional Economics (along with Austrian subjectivism and Public Choice theory) inspires Pejovich’s “interaction thesis”. Institutions consist of formal and informal components characterised by four types of relationship: 1) formal institutions can suppress, but cannot change, informal institutions, which implies that the attempt by formal rules to change informal norms will fail, and that the latter will persist for a long time; 2) formal and informal rules can be in conflict; 3) formal rules can be either ignored or rendered neutral, as happens when people refer to social norms to resolve disputes instead of resorting to the legal system; 4) formal and informal norms can coexist in harmony (Pejovich, 1999, pp. 170-1). This typology, rather than focusing on criteria which govern the relationships between kinds of norm, describes some institutional phenomena. But it is precisely these criteria that are in need of clarification. Relationship (1), which delineates a conflict between types of norm, could apparently be included in relationship (2), also because Pejovich himself admits that the difference between (1) and (2) is “merely one of degree” (1999, p. 170). By contrast, the two kinds of relationship are dealt with separately. The various forms of conflict between types of norms are examined to only a limited extent, with the consequence that, as for Nee (1998), it is unclear what criteria are involved in this typology. Pejovich remarks that in many cases formal rules have failed to change informal rules. This implies that informal norms survive within systems of alternative formal norms – as illustrated by the history of the Serbs, who preserved their informal institutions for five centuries under Turkish domination. However, the survival of a group’s informal norms

is not a sufficient condition to establish whether these norms are really in conflict with formal rules, or whether they are in some way integrated into them. Similarly, the reasons for the neutralisation of certain formal rules (relationship (3)), and the exact meaning of the “harmony” between formal and informal norms (relationship (4)), could be discussed in more detail. Here “harmony” is viewed in relation to the process which leads to the legal institutionalisation of informal rules. But this evolution sometimes does not occur. In this case, formal norms do not replace informal norms, although both kinds of norm cooperate harmoniously.

New Institutionalism has also influenced political science, and comparative studies in particular. Lauth (2000, pp. 23-6) observes that in democracies formal and informal institutions<sup>3</sup> exhibit three different kinds of relationship (i.e. *complementary*, *conflicting* and *substitutive*), and Helmke and Levitsky (2004), who expand Lauth’s typology, add to these a fourth type (i.e., *accommodating*). Their analysis of the four kinds of interaction concerns two interrelated dimensions: the degree to which formal and informal institutions converge or diverge, and the effectiveness or ineffectiveness of formal rules. *Complementary informal institutions* make it possible to deal with contingencies not covered by formal rules. They reinforce formal rules and provide incentives to enforce them. *Accommodating informal institutions* modify but do not breach formal norms, “they contradict the spirit, but not the letter, of the formal rules” (p. 729). *Competing informal institutions* emerge when formal norms are ineffective and are ignored or violated by actors. An example is post-war Italian corruption, perceived as a **norm alternative** to the law of the state but which individuals choose to follow. *Substitutive informal institutions* arise when formal rules are weak and when the State exhibits a lack of authority.

Helmke and Levitsky (2004, p. 726) are “concerned only with political rules of the game”, and not – like this paper – with how norms prove to be an essential component of social and economic institutions. Their treatment – although valuable in many respects – only partially focuses on principles which explain relationships between formal and informal institutions. This is probably the cause of some methodological problems. For example, it is not clear from a methodological point of view why “substitution” is considered to be a distinct notion, rather than a special case of “complementarity”. As “complementary informal institutions”, “substitutive informal institutions” are employed by actors who “seek outcomes compatible with formal rules and procedures” (p. 729). In this way, they “fill the gap” left by fragile formal institutions, as in the case of the informal *rondas campesinas* (self-defence patrols), which in northern Peru replaced inadequate police protection (p. 729). Therefore, the weakness of formal institutions is seen as a condition which allows the emergence of relationships of complementarity.<sup>4</sup>

A similar reasoning also applies to the conceptual pair “accommodating” and “competing informal institutions”. Both these terms refer to a large area of conflict between norms, and as such they should not be considered as separate notions. However, when accommodating institutions “help to reconcile [...] actor’s

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<sup>3</sup> In this literature the **expression** ‘formal/informal institutions’ usually replaces ‘formal/informal norms’.

<sup>4</sup> This feature is also shared by “competing informal **institutions**”; but in this case the weakness of formal institutions allows the expansion of informal institutions based on phenomena such as clientelism, patrimonialism and corruption, which deteriorate formal norms.

interests” (p. 729), they work as complementary institutions.

The above-mentioned classifications differ from the approach presented in this paper, which examines the relationships between formal and social norms in **regard more** to their impact on the social lives of individuals and in terms of single rules than their influence on the political sphere and on society as whole (as in Hayek’s and North’s views, and in analyses of political systems), although both perspectives concern the institutional bases of social systems.<sup>5</sup> Moreover, although these typologies are accurate in many respects, they do not sufficiently develop a perspective able to clarify the criteria on which they are constructed (a gap that this paper tries to fill). One consequence is the proliferation of concepts that, although able to describe a variety of empirical cases, do not delineate a clear logic governing the relationships between formal and informal norms. This paper suggests that such a basic simple logic is rooted in the **notions** of complementarity and conflict, two theoretical criteria which are discussed in the following sections.<sup>6</sup>

### 3. Relationships between social norms and legal norms

The boundaries between legal and social norms are often nuanced, and it is empirically difficult to establish whether behaviours such as not smoking in certain public spaces derive from sensitivity to social norms or, alternatively, from the fear of legal sanctions (or from both). Although boundaries can be uncertain, in situations of this kind, social and legal norms perform complementary functions, and since this complementarity contributes to social coordination it may be interpreted as a sort of cooperation between two kinds of norms which exhibit different features. As a first approximation, two different kinds of complementarity may be distinguished: a) complementarity which admits replacement between legal and social norms (henceforth C1); and b) complementarity which does not admit replacement (henceforth C2).<sup>7</sup>

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<sup>5</sup> Voigt and Engerer (2002, p. 136) also provide a classification inspired by the New Institutional Economics, but they do not specify the conceptual terms by means of which their concise scheme is constructed.

<sup>6</sup> One exception is Kostrisky (2013), who considers some methodological problems. See also Zasu (2007) and Azari and Smith (2012).

<sup>7</sup> The notion of “institutional complementarity” is at the core of institutional comparative analysis, an approach which studies the diversity of capitalism, and develops Aoki’s (1994) analysis. Institutional complementarity indicates that the efficiency of an institution A is influenced by the presence of another institution B, and *vice versa* (Amable, 2003 p. 6; Hall and Soskice 2001, p. 17). Economic systems differ because they are not random collections of institutional forms working in isolation but sets of complementary institutions (Amable 2003, p. 6). This concept differs in many respects from the notion of complementarity that I use in this paper. I focus on complementarity between kinds of norms, rather than on institutions like labour markets, training institutions, and financial systems. This entails an analysis of how, in each institution, formal and informal norms are complementary or in conflict. Moreover, the varieties of capitalism approach is “actor-centred” (Hall and Soskice 2001, p. 6), while my approach is centred on norms and on how these condition individual behaviours. For this reason, I do not adopt the notion of agents’ “strategic interaction” (Hall and Soskice 2001, p. 5; Amable 2003, p. 41). However, if the focus is shifted to **norms**, the *general* idea of

### *3.1 Complementarity which admits replacement (C1)*

The law cannot prescribe (or proscribe) human behaviour in every detail. Consequently, a certain amount of space remains for the role of social norms in supporting and reinforcing legal action. When the law prohibits specific actions or produces incentives, it does not define all the contexts in which prohibitions and incentives have to be enforced. This condition implies that social norms can intervene in areas contiguous to the law – where the law is silent – and reinforce its operation. These two kinds of rules not only coexist; they also cooperate, and their proximity under certain conditions implies that the former may erode the latter.

Let us suppose that the law prohibits smoking in cinemas. This legal prohibition is given additional force by an unwritten social norm which suggests that smoking should be avoided in many other situations: for example, in public gardens where children or pregnant women might be present.<sup>8</sup> The two types of norm are consistent, and they reinforce each other. In a sense, the entire area of sanctions consists of legal and social sanctions, where the more one component increases, the more the other is reduced. If the law subsequently changes (and gradually bans smoking in restaurants, public offices, train stations, public gardens, etc.), the need for penalties imposed by social norms diminishes or changes. One function of the social norm (that is, preventing or limiting a certain behaviour) has been eroded by, and incorporated into, a legal norm. However, the social norm does not vanish, because it continues to perform other functions contiguous to the law, such as communicating disapproval. Only one specific function of the social norm decays, while the others persist. Therefore, the social norm redefines its role and the spaces in which it operates; consequently, the relation of complementarity between legal and social norms is also redefined. The process of substitution also operates in the reverse direction, when social norms replace formal norms. The norm ‘defend members of your community’ can be applied by informal organisations such as self-defence patrols instead of by the police if the latter are too weak to perform this function.

Another aspect is involved in type C1 relationships. Although legal and social norms cooperate, they also virtually compete in establishing the part that each of them plays in penalising people who do not abide by certain behavioural rules. They tend, as it were, toward the same end (for example, the prohibition of smoking), but the determination of the extent of the spaces occupied by legal and social norms respectively in performing **the function** of prevention depends on a sort of competition between them.

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complementarity (that one institution reinforces the other), is shared by my approach, which describes how under certain conditions one kind of norm reinforces the other.

<sup>8</sup> However, the social norm, too, can receive additional force from the law, since if the latter prohibits smoking in restaurants, this gives strength to sanctions imposed by social norm in analogous situations.

Rules on recycling, wearing seatbelts in cars, or using helmets while riding motorcycles are all examples of social norms which can become legal norms. Complementarity of type C1 can be described as the interaction of legal and social norms. If a legal norm expands its sphere in relation to a specific function, the social norm loses part of its domain of enforcement and, in the new circumstances, the legal norm regulates behaviour previously regulated by the social norm: the more a legal norm incorporates a function of a social norm, the more it erodes the role played by the social norm. This entails a sort of competition between the two kinds of rule in order to establish which of them performs a certain function; but at the same time it implies that there is *strict homogeneity* between the two kinds of rule, because this condition allows one to replace the other. In principle, this process of substitution will end when a legal norm has completely replaced a social norm; **that** is, when that particular function previously performed by a social norm has been completely incorporated into a legal norm. However, it is evident that this is not a necessary outcome.

Many authors have pointed out that the replaceability of social norms with legal norms derives from the fact that law is moulded on the basis of preceding informal norms. This tradition of thought includes Hume, Burke, von Savigny, Maine, and many others. Hayek, on the basis of the notion of group selection, interpreted this process in evolutionary terms. In other cases, the idea that legal institutions are consequences of previous social norms does not refer to evolutionary schemes; rather, it is a conclusion deriving from game-theoretic approaches (Sugden, 1989) or from historical analysis (North, 1990). However, the condition of strict homogeneity involved when a legal norm replaces a social norm does not **centre** on the general relationship between informal and formal norms in society pointed out by authors such as Hayek and North; rather, more limitedly, it concerns the relationships between single (social and legal) norms.

The evolutionary view of institutions has been criticised, and this has **led to re-consideration** of how formal norms influence and give shape to informal rules. Legal scholars have analysed the reverse process – that is, how law influences and even modifies social norms (see Sunstein, 1996a; McAdam 1997, p. 342) – and they have pointed out that law is not a mere extension of customs.<sup>9</sup>

Social and legal norms sometimes do not interact. When they appear separately, two cases have to be taken into consideration: 1) the predominance of a legal norm, which *can* be – but not necessarily *is* – a consequence of a process of substitution; 2) the predominance of a social norm as a norm which regulates a behaviour without the help of law. **In this** regard, North (1990, p. 38) observes that, at institutional level, “In the absence of the state and formal rules, a dense social network leads to the development of informal structures with substantial stability”. In short, except for extreme cases in which either legal or social norms dominate, it frequently occurs that legal and social norms interact. This latter situation has a number of

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<sup>9</sup> For a general analysis of contemporary studies on social norms and law, see Mercurio and Medema (2006, pp. 306-41).

gradations, in which the extent of the space occupied by one kind of norm varies in comparison with the other, and implies that behaviours can be more sensitive to one than the other, although both cooperate with and reinforce each other.

Relationships between legal and social rules cannot always be labelled in terms of C1, since certain components of social norms and certain conventions, although they are complementary with legal rules, cannot be replaced by law. This is type C2 complementarity.

### ***3.2 Complementarity which does not admit replacement (C2)***

Fining people who smoke in places where it is prohibited may be interpreted as a transformation of the breach of a norm into a market transaction, where the fine can be interpreted by the individuals involved as the price paid for smoking (Fehr and Falk, 2002, p. 711). This may suggest that, by means of fines, the law neutralises the moral view incorporated in a social norm and that smoking in forbidden areas does not give rise to disapproval when a monetary sanction is imposed.<sup>10</sup> However, the monetization of a social norm (i.e. its replacement with a formal one) is not always possible, and sanctions cannot always be equated to fines or prices. Robert Cooter (1984) criticizes the propensity of economists to view law as “a set of official prices”, and to think that sanctions are prices.<sup>11</sup> This is erroneous, since prices are perceived as external constraints, while sanctions refer to obligations perceived as social norms. Moreover, “A sanction is a detriment imposed for doing what is *forbidden*, such as failing to perform an obligation”, while “a price is a payment of money which is required in order to do what is *permitted*” (pp. 1524-5; emphasis in the original). This distinction makes it possible to specify the different social meanings embodied in sanctions (such as imprisonment) and fines (such as prices) and to focus on the “expressive dimension” of punishment. Punishment, Kahan (1996) maintains, is a convention that conveys moral condemnation by society and reaffirms the values that the wrongdoer denies. Fines express these messages less potently, and condemn much more ambivalently. In short, “Imprisonment, as a sanction, invariably condemns; fines, when viewed as prices, do not” (p. 621).<sup>12</sup>

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<sup>10</sup> Moral norms are often viewed as a subclass of social norms (see Hausman and McPherson, 2006, p. 81, Shavell, 2002, p. 23, note 5; Cooter, 1988, p. 586).

<sup>11</sup> This view is put forward by Gary Becker (1968, p. 195), and it is shared by R. Posner (1980).

<sup>12</sup> The relationships **among** prices, fines and social norms can be illustrated as follows. Fines and prices do not convey the same meaning and perform different functions. Fines are usually attached to moral disapproval (see Sandel, 2013, pp. 128-129), while prices usually are not. In their turn, fines are not social sanctions for the same reason: they convey the social view of punishment imperfectly but more effectively than prices.

These considerations may usefully serve to formulate a concept which has not emerged in these debates: the relationship between legal and social norms is characterised by a complementarity of type C2. This occurs when the expressive function of a social convention or norm cannot be eroded by law because its social meaning cannot be transferred to penalties such as fines (owing to the lack of strict homogeneity). More generally, when the law cannot neutralise or eradicate the moral disapproval attached to social norms, the relationships between different kinds of norms involve a type C2 complementarity. This is coherent with the view suggested in the previous section: C1 complementarity entails that only one function of a social norm (for example, preventing a certain behaviour) can be eroded, while others – not eradicable by law – persist (for example, conveying disapproval). Therefore, the latter are included in complementarity of type C2.

C2 complementarity appears in situations where conventions, customs and traditions are the complements of social, political and legal acts, but are not replaceable by law.

Norbert Elias ([1969] 1994) has shown how rules of etiquette are crucial for understanding the process of Western civilization. The emergence of political, economic and legal systems does not constitute the only factor able to shape a society; rather, “civilization” is probably better understood **in light** of other subtle and pervasive processes which connote it. In fact, civilization is largely characterized by a number of rules which are fundamental traits of social systems and are not legally prescribable, such as, for example, good table manners and dress codes. These kinds of norms are mostly social conventions exhibiting two characteristics which differentiate them from other socially shared rules: they are obeyed because other people are obeying them, and they are in some degree arbitrary (Dequech 2009, p. 73).<sup>13</sup> By means of symbolic behaviours, conventions signal certain attitudes (in the same way as saluting the flag signals loyalty and patriotism), and communicate whether or not individuals are co-operators (i.e., patriots or not) (E. Posner, 1998), even if there is no intrinsic reason why one signal should be used rather than another.

Lévi-Strauss pointed out that some contemporary social conventions and norms derive from the social practices of primitive communities, whose functions have been inherited. Their present form, apparently obscure and characterised by arbitrary symbolic behaviours, derives from ancient ceremonials. Although reciprocal gift-giving has lost its original social, religious, magical and economic meanings, certain conventions and customs in contemporary societies evoke the ancient conception of exchange. Dinner is “offered” to a person one wishes to honour, and this behaviour can be a way of “returning” an act of kindness. Things offered to the guest, like good food and good wine, and objects used in **his/her** honour,

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<sup>13</sup> According to Lewis (1969), conventions do not derive from explicit agreements; rather, they emerge from repeated coordination games, and from shared knowledge on behavioural regularities that coordinate individual actions. On this view, they are solutions to coordination problems and, as Sugden (1989) maintains, it is rational to follow a convention, even though it is only one of the several solutions of a game.

like **tablecloths** habitually stored away in cupboards, are part of the ceremonial (Lévi-Strauss, [1949] 1969, pp. 52-68).

These conventions cannot be replaced by legal prescriptions, and they constitute a framework in which legal rules are created and find support. More than being the 'rules of the game' which give shape to social coordination and regulate behaviours, roles, and hierarchies, they support other norms that more effectively perform these functions. In short, some informal norms of kindness, politeness, appropriateness of behaviour, etc., reinforce the sense of belonging to a community, reduce conflicts between groups or political parties, convey consensus on democratic procedures, facilitate cooperation, and help the application of laws. They also favour social coordination by supporting social norms, and cannot be replaced by legal norms because they operate within a social and cultural space which is fundamentally different from that of laws. Hence there is no strict homogeneity between the two types of rules, and the relation between social and legal norms does not evolve in the direction of the replacement of the social norm.

### **3.3 Conflicts between norms**

Social norms not only take on a complementary form with respect to law, as shown by C1 and C2; they also often conflict with legal rules.

The conflict between norms can assume two forms. The first is "prohibition", which takes place when one kind of norm prohibits specific behaviours recommended by the other type of norm. The second emerges when the two kinds of norms are mutually exclusive, and adherence to one norm crowds out the other. In this case, there is no prohibition, but simply incompatibility between norms which cannot be enforced at the same time. While complementarity of type C1 and C2 are describable as 'legal *and* social norms', the two aspects of conflict are summarised as 'legal *or* social norms'.

Duelling and codes of revenge are examples of social norms which conflict with (and are prohibited by) legal norms.<sup>14</sup> One intriguing question is how the coexistence of these kinds of rules can be explained, given that each individual is supposed to abide by them notwithstanding the fact that they are in conflict with each other, as happened when people with institutional roles fought duels to resolve disputes and perceived the two kinds of rules as equally legitimate, although in the nineteenth century the law

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<sup>14</sup> Law can prohibit adherence to social norms, and in turn social norms can stigmatise behaviours favoured or ruled by law.



prohibited duelling in many countries.<sup>15</sup> One may assume that the two different kinds of norms respond to social and cultural demands in incompatible ways; nevertheless, it is not clear why two (and, in principle, more than two) *alternative* systems of rules, which are outcomes of the same history and the same culture, should be enforceable at the same time. This reinforces the idea that formal norms are not simply complementary extensions of informal norms (Hodgson, 2009), and that the notion of conflict between different norms reveals problems that are not examined by authors such as Hayek and North. Although prohibition characterises antagonism between different kinds of norms, conflict can in practice assume nuanced forms. Informal norms embodied in corruption, clientelism, political patronage and clan politics corrode legal and formal norms, and are sanctioned by law; but at same time they prosper thanks to formal institutions, from which they extract resources (Lauth 2000, pp. 25-6). Therefore, the term “conflict” (in the sense of “prohibition”) indicates that the two kinds of norms are **in principle opposite** to each other, although in real life they coexist more or less precariously.

Relations of conflict can assume a less radical form, which implies *mutual exclusiveness* between kinds of norms, but not prohibition. Mutual exclusiveness means that a person can choose what type of rule to adopt, where the available kinds of norms are related to alternative motivations. Suppose that a man is attacked by his neighbour’s son, who has drunk too much, in consequence of a quarrel about parking. The man, who is a friend of the aggressor’s father and knows that his family is going through a difficult period, decides not to report the neighbour’s son to the police. Social norm and law, from which there follow alternative behaviours, are available at the same time and can be freely pursued, yet one type of rule makes the other unusable.

The same phenomenon is observable at the social and institutional levels, when customs and extra-legal agreements dominate because the corresponding law is not enforced. It is in this sense that it is possible to reformulate Robert C. Ellickson’s (1991) analysis, which shows how ranchers in Shasta County, California, resolved disputes arising over cattle trespass **of** boundary fences by resorting to informal norms instead of relying on laws, although the latter were available (see also Bernstein, 1992). In addition, comparative studies have shown that this scenario can emerge when State structures and formal authority are weak.

Finally, the outcome of mutual exclusiveness must not be confused with the possible outcome of the evolution of the cooperative relationship between social and formal norms (C1 complementarity, which implies ‘replacement’), although both outcomes show the prevalence of one kind of norm and the disappearance of the other. In mutual exclusiveness, in consequence of the conflict between social and formal norms, the adoption of one kind of norm implies the rejection and not the replacement of the alternative rule. Alternatively, the prevalence ‘by replacement’ of one kind of norm, which arises from C1

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<sup>15</sup> Alexander Hamilton was killed in a duel in 1804, and Felice Cavallotti, a member of the Italian parliament of the kingdom of Italy, died in 1898 after fighting a duel, although **duelling** was prohibited by Italian law.

complementarity, is possible not because the alternative type of norm has been rejected, but because one of its functions has been incorporated.

### 3.4 Moveable boundaries between norms in space and in time

The boundaries between the two types of complementarity and between these and the conflicting relationships between social rules and law are moveable – as the following situations, in reference to the use of seatbelts, illustrate. In many Western countries this behaviour involves the relationship between type C1 social and legal norms, since the informal norm which once suggested the use of seatbelts has been transformed into a legal prescription. But, in other countries, this norm remains a rule of good sense, which tends not to assume the form of a law.<sup>16</sup> In this case, it can be included in **C2** if a social norm complements legal rules but does not exhibit a tendency to be replaced by a law. Finally, the legal prescription which imposes the use of seatbelts may conflict with a social norm, as in the case described by Lessig (1995, p. 952), where wearing a seatbelt in a taxi in Budapest during the 1990s was an insult to the driver.

The scheme below summarises the relationships between legal-formal rules and informal social norms.

Legal <i>and</i> social norms	Relationships of complementarity of types C1 and C2.
Predominance of the legal norm  Predominance of the social norm	These constitute the extreme possibilities of 'legal <i>and</i> social norms', when one of the components (either a legal norm or a social norm) predominates. If, as a consequence of the erosion of the social norm, a legal norm prevails, then the previous situation ('legal <i>and</i> social norms') denotes type C1 complementarity.
Legal <i>or</i> social norms	Relationships of conflict between kinds of norms both as prohibition and as mutual exclusiveness.

<sup>16</sup> The relationship between formal and informal norms becomes more complex if one considers non-Western countries. However, such an analysis would fall outside the scope of this essay.

#### 4. Formal rules and informal social norms in the economic sphere

In the economic sphere, and specifically in the market, the relationships between different types of rules exhibit features similar to those characterizing legal and social norms, since transactions take place within legal and formal frameworks which regulate exchanges by means of contracts and through the definition of property rights. For this reason, North (1990, p. 47) points out that economic **rules** which define property rights and **contracts must** be included within a larger class of formal norms along with political and judicial rules. In his view, exchanges in modern market societies, where bargaining is a complex activity, must be accompanied by third-party enforcement, and by institutions that enforce agreements through the threat of coercion. Consequently, legal and economic norms facilitate exchanges, and they are enforced by legal and political decision-making.

Since transactions in the economic sphere are ultimately guaranteed by legal institutions, I will use the expression “market norms” to summarise the idea that exchanges in the market are structured in a formal way, and that these formal aspects of the market are usually associated with a monetary dimension (see Ariely, 2008, p. 68). However, the behaviour of individuals as economic agents is also influenced by informal social norms, which guide their **behaviours especially** when contracts are incomplete. As a consequence, complementarity and conflict characterise relationships between market and social norms.

These themes are present in Karl Polanyi<sup>17</sup>, although 1) he does not make explicit the concepts of complementarity and conflict; 2) his analysis focuses mainly on institutions as a whole rather than on norms. His fundamental work, *The Great Transformation* (1944), is an analysis of the “double movement”, that is, the struggle between forces which support the self-regulating market, and forces which **try** to protect society from the inequality and degradations caused by the market (Polanyi [1944], 2001, pp. 139-40). Polanyi interprets this conflict as manifesting the fact **that**, in modern market economies, economic activities tend to be separated from the social sphere. In response to this **tendency**, society tries to defend itself and to “re-embed” economic **activity in the** social domain (Polanyi [1944], 2001, p. 132). Despite the tendency of the market to detach itself from other dimensions of social life, this process cannot be fully realized. The idea of a self-regulating market as a disembedded institution is utopian because the economy necessarily interacts with spheres such as law, politics and morality. In general, “The human economy [...] is embedded and enmeshed in institutions, economic and noneconomic. The inclusion of the noneconomic is vital” (Polanyi *et al.*, 1957, p. 250). These reasons, together with the fact that market society tries to re-

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<sup>17</sup> I thank a referee for directing my attention to Polanyi’s approach and its possible connections with the themes developed in this paper.

embed the economy by means of social protection, explain why, according to Block (2003), Polanyi glimpsed, but did not develop, the idea of the “always-embedded market”.<sup>18</sup>

Although Polanyi did not directly analyse the relationships between formal-market and social norms, he provided a framework in which to consider the relationships of complementarity or conflict between institutional structures. The coexistence of economic and social relationships involves complementarity. However, this coexistence also denotes forms of conflict in market economies which are related to the *double movement* and to countermovements which characterise society’s defence against the market.

Many approaches have developed Polanyi’s view and refer to the concept of “embeddedness” and “countermovement” in order to interpret the dynamics of modern economies. According to Laville, Lemaître and Nyssen (2006), who adopt Polanyi’s approach, social enterprises are characterised by socio-political embeddedness. They are founded by social workers, associative militants and representatives of the traditional third sector, which in recent decades has implemented labour market policies (pp. 280-2). Social economy is viewed as a field which brings together co-operatives, mutual societies and various organizations (such as non-profit ones) whose aim is to benefit their members or the community. Following Polanyi’s substantive approach to the economy, Defourny and Nyssen (2006, pp. 10-11) consider social enterprises as organisations which “combine the economic principle of market, redistribution and reciprocity”. All this evokes the notion of complementarity, in that these forms of social protection allow the better functioning of economic relationships. The conflict between market and social forces has also been investigated by many studies, which **have examined** in Polanyian terms how increasing inequalities in income, health and life chances have come about in recent decades (Roy and Hackett 2016, p. 2). Moreover, market deregulation has had a human, environmental and financial impact on “developing” countries that many consider to be harmful and the origin of Polanyian countermovements (Levien 2007, Sandbrook 2011).

However, these perspectives refer to institutional and political processes which are general in nature. **Instead** the analysis which follows focuses more specifically on norms. In particular, it examines how in the economic sphere the relationships between formal norms and informal social norms can be interpreted in terms of either complementarity or conflict. (type C1 or C2).

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<sup>18</sup> This point, and in general the notion of “embeddedness”, has been much discussed in **the** secondary literature. Lie (1991) maintains that Polanyi overestimated the purely economic character of market exchange, while he underestimated the fact that “all economic activities and institutions are embedded in social relations” (p. 219). Gemici (2008) remarks that Polanyi contradictorily states that all economies are embedded in institutions and that the market economy is disembedded. Dale (2010, p. 193) recognizes that the concept of embeddedness exhibits some ambiguities and that, at the methodological level, it is uncertain whether this concept **is a “descriptive empirical term” or an “ideal type”**.

#### 4.1 Complementarity of norms in the economic sphere

Scholars belonging to different schools of thought implicitly recognize complementarity between social and legal-formal norms in economic relationships, although they have not formulated a theory on this phenomenon. The consequence is that complementarity is not analysed as a conceptual category, although some approaches are compatible with this perspective. Hodgson (1988) hints at the notion of complementarity, though he does not develop it theoretically, when he maintains that contracts and exchanges are “a combination of both formal legislation and legitimation, and inherited custom and tradition of a less formal kind” (p. 156). Contracts are integrated by customs and conventions, and this implies that “the analysis of exchange in modern society has to be understood through an examination of the symbiotic relationship between *both* its contractual and non-contractual features” (p. 167, emphasis in original).

The “symbiotic relationship” between informal and formal contracts can be viewed in terms of their complementarity, especially in labour contracts, which, Akerlof (1982) maintains, are in part based on gift relationships. The gift from the worker consists in a work effort which is “in excess” of the minimum standard, and the firm’s gift consists in wage “in excess” (or other benefits): that is, a wage higher than the one prescribed by the work rules. In Akerlof’s words: “In gift exchange the usual norm is that gifts should be more than the minimum required to keep the other party in the exchange relationship” (p. 559). Formal norms which determine the minimum standard for both workers and the firm, and the social norms of reciprocity which regulate what exceeds it (and which give rise to the gift from both the parties) can be viewed as complementary rules. This emerges as a consequence of Akerlof’s argument, although he does not analyse this concept in theoretical terms.

Social norms have a role in determining workers’ performances, especially if incomplete contracts allow degrees of discretion in work effort, and cooperation is elicited by means of the generous reward offered by employers.<sup>19</sup> Fehr and Gächter maintain that the social norm of reciprocity contributes to the enforcement of contracts, and they argue that implicit contracts stimulate higher than expected levels of effort, thus determining higher profits. The reason is that the employers’ commitment to paying a bonus related to the effort level is based on their reciprocal inclinations (Fehr and Gächter, 2000, p. 177). By contrast, explicit (more complete) contracts induce effort levels that are lower than expected because they

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<sup>19</sup> Incomplete contracts theory, as conceived by Grossman and Hart (1986) and Hart and Moore (1990), develops a perspective whose origins are to be found in Coase, Williamson, and Klein, Crawford and Alchian, and in the concept of transaction costs. Contracts are incomplete for many reasons: 1) **because** some characteristics of transactions can be known only *ex post*; 2) **because** *ex ante* specification of costs can be excessively high in some states of the world; 3) **because** some behaviours may not be observable by a third party. This implies that some *ex post* opportunistic behaviours occur and that contractual incompleteness causes distortions in firms’ performances. These approaches, differently from the present paper, deal with problems of the optimal allocation of asset ownership.

are likely to erode cooperative reciprocal behaviours. When an incomplete contract is replaced by a complete (or more complete) contract as a result of the erosion of the contract component based on social norms, the outcome is generally inefficient. In my terms, C1 complementarity characterises the change from incomplete to complete contracts, but this outcome is less preferable than that in which social norms cooperate with the formal norms of the market.<sup>20</sup>

Another case which illustrates, but does not develop in conceptual terms, a complementarity which admits 'replacement' is described by Gneezy and Rustichini (2000a), who studied a day-care centre in Israel in order to evaluate whether introducing a fine for parents who arrived late to pick up their children was a useful deterrent. They concluded that the fine did not work well. Before the fine was imposed, teachers and parents had an agreement, based on a social norm, about how to behave in the event that parents arrived late. In this way, when parents were occasionally late, they experienced feelings of guilt which induced them to be punctual. When the fine was introduced, the social norm was replaced by a market norm (i.e., a new contract). Now that the parents were paying for their tardiness, they interpreted the situation in formal terms. Since they were being fined, they could decide whether or not to be late, and they frequently chose the former option. Eventually, when the fine was removed, the behaviour of the parents did not change, and they continued to pick up their children late.

In the terms that I have adopted in this paper, the relationships between formal and social norms before the fine were characterized by complementarity, which admitted a 'replacement' similar to that previously identified as C1. The contract was incomplete (Gneezy and Rustichini, 2000a, p. 3), because at first a social norm intervened where economic exchange ceased; that is, when the payment for day-care services did not include free (benevolent) assistance for children whose parents arrived late. After the introduction of the fine, a formal rule replaced the social one, and the relations between the parties were entirely ruled by market norms. However, the erosion of the previous social norm did not produce an efficient result because it did not reduce but actually increased the number of parents who arrived late.

Complementarity introduces a perspective whereby it is possible to examine the contractual incompleteness and behaviours described by Gneezy and Rustichini. Moreover, it is worth noting that the characterization of complementarity as the capacity of social norms to fill the gap in formal norms, given

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<sup>20</sup> Adaman and Madra (2002) criticise approaches ontologically based on individualism and methodologically based on formalism because they represent individuals as detached from a social and institutional context. These approaches also support an ontology of contracts in which the market-centric view prevails, and in which the "third sphere" (which includes various activities which remain outside the sphere of exchange) is narrowly conceptualised as pathological and as supplementing contractual relationships. Adaman and Madra maintain that the notion of "homo reciprocans" propounded by Akerlof and Fehr and Gächter is in some way related to the ontology of contracts: that is, it reflects a conception of the individual as rational and calculative. However, they recognise that Akerlof "moves beyond the terrain of strict individualism" (p. 1065) (on this aspect see Davis (2007)). In my view, this type of revision of the standard approach makes it possible to reframe contributions by authors such as Akerlof, and Fehr and Gächter within an institutional perspective based on complementarity and conflict.

the incompleteness of contracts, is only one particular case. Social norms can complement formal norms also when these latter are well-designed. To summarise, C1 complementarity in the economic field may entail that the replacement of a social with a formal clause assumes the form of monetisation. This process is peculiar, since in many circumstances the replacement engenders inefficient results; and for this reason, although erosion is possible, it is better not to destroy social norms: cooperation between market and social norms is preferable to domination by market rules alone (see Sandel, 2013), where this latter term indicates a formal contract implying a monetary dimension.

However, social norms cannot always be replaced by monetary compensation, and when this occurs, the relationship between norms is characterized in terms of type C2 complementarity (North, 1990, p. 63).

#### **4.2      *Conflict between formal and informal social norms in the market***

Economic formal norms and social rules may be antagonistic. There is a radical opposition between legal and illegal markets. Gambling, prostitution, and narcotics markets “can continue only because the participants recognise *de facto* the property rights that the state does not” (Sugden, 1989, p. 86). They come into existence in consequence of codes of behaviour that govern them, and they persist despite the attempts by legal institutions to suppress them. Therefore, the form taken by conflict between the two systems of norms implies that one of them prohibits a certain behaviour recommended by the other. This antagonism concerns the fact that, in principle, behaviours which follow one kind of norm are incompatible with the other; in practice, however, they can exhibit an ambiguous relationship – as in the case of corruption, where informal groups and organizations parasitically prosper at the expense of formal institutions. However, in this section I shall concentrate on the less radical form of conflict (**mutual exclusiveness**) which entails that the presence of one type of norm crowds out the other type, without this event involving prohibition.

Titmuss, in his *The Gift Relationship* (1970), put forward the idea that payment for blood donations reduces or eliminates the willingness to donate blood because it represses social and ethical norms associated with the act of donation. Donation of blood as a gift and as a marketable good are *mutually exclusive*, and refer to two different kinds of norms, namely, to use Ariely’s expressions (2008, p. 68), “social norms” and “market norms”.

The consequences of tangible compensations have been debated by psychologists. Deci and colleagues (1971; 1999) have argued that monetary rewards undermine intrinsic motivations – that is, motivations which are independent of external rewards and may depend on the internalisation of social norms. These

arguments have been examined by non-standard economic theory, which points out that, while standard economic theory predicts that raising monetary compensation will improve performance, experimental findings show that raising monetary compensation worsens it. Frey and colleagues (Frey and Oberholzer-Gee 1997) argued that monetary rewards can destroy intrinsic motivations, as proved by a survey which showed that monetary incentives limited the acceptance of a nuclear waste repository by residents in two communities in Switzerland, because the sense of civic duty had been crowded out (Frey and Oberholzer-Gee, 1997. See also Gneezy and Rustichini, 2000b).

Intrinsic motivations and extrinsic monetary motivations produce different behaviours because they are characterised by conformity with different systems of rules. This is the contention of Ariely (2008, p. 68), who argues that “we live simultaneously in two different worlds – one where social norms prevail, and the other where market norms make the rules”. Heyman and Ariely (2004) have noted that people usually apply these kinds of norms **separately because** they are mutually exclusive. It is easy to imagine the consequences of behaviour which treats private situations in monetary terms (such as paying your mother-in-law for having participated in her Thanksgiving dinner): the introduction of “market norms” into social rules by means of monetary payments may generate conflict and damage social relationships.<sup>21</sup> In short, when people operate in a “monetary-marketplace”, they refer to a sort of formal contract through which they expect corresponding compensation. By contrast, when they refer to a social norm, monetary rewards may be perceived as disincentives.

In my terms, this view describes mutual exclusiveness between the formal norms of the market and social norms. When a formal norm of the market invades the space of a social norm and exchange assumes a monetary form, this produces negative effects because the social norm is crowded out. The two kinds of norm are incompatible, although this does not imply ‘prohibition’.<sup>22</sup>

There are other circumstances in which informal social norms and formal rules associated with the functioning of the market are mutually exclusive. Jon Elster (1989, p. 110) describes a type of behaviour for which it is possible to define the underlying social norm, starting from an example suggested by Amos Tversky:

“Consider a suburban community where all houses have small lawns of the same size. Suppose a houseowner is

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<sup>21</sup> The reverse situation, too, in which formal exchange relations are conducted through informal codes of friendship, or as family relationships, would probably be problematic.

<sup>22</sup> This situation is similar to the one explained at the end of subsection 3.3. Here, in particular, both erosion (complementarity of type C1) and the crowding out (conflict as mutual exclusiveness) of a social norm by a formal norm, discussed in this subsection and in subsection 4.1 respectively, produce negative effects. Despite this similar outcome, erosion is possible if there is strict homogeneity between the formal and the social norm, while crowding out implies that a formal norm cannot replace a social norm, because the condition of strict homogeneity is not met. Therefore, the social norm is simply removed, not eroded.



willing to pay his neighbor's son ten dollars to mow his lawn, but not more. He would rather spend half an hour mowing the lawn himself than pay eleven dollars to have someone else do it. Imagine now that the same person is offered twenty dollars to mow the lawn of another neighbor. It is easy to imagine that he would refuse, probably with some indignation. But why is mowing one lawn worth \$10 or less, while mowing an identical lawn is worth \$20 or more?"

The social and formal market rules with which the homeowner can alternatively conform his behaviour are in conflict since enforcement of the former impedes enforcement of the latter. Of course, a very high monetary reward might induce the homeowner to change his mind, but this possibility is usually unrealistic. He can establish a market relation as an employer of the neighbour's son, but he cannot play the role of a worker who occasionally mows the lawn of a neighbour for **money because** this function contrasts with other social identities and norms that connote his conduct. The economic and social roles that he performs are mutually exclusive and operate in distinct domains. According to Elster (1989, p. 110), part of the explanation for the homeowner's indignation at the proposal that he enter into a market relation is the fact that he "doesn't think of himself as the kind of person who mows other people's lawns for money", simply "*it isn't done*", and this is a "revealing phrase that often accompanies social norms".

Another example of conflict between market and social norms is the Ultimatum Game, which describes how pro-social and market behaviours are antagonistic. In this game, two players (a Proposer and a Responder) **can** divide a certain amount of money provided by the experimenter. The Proposer makes a proposal on how to divide this sum, which the Responder can accept or reject. If the offer is accepted, the money is divided as proposed; if it is rejected, neither player receives anything. Usually, modal offers are around 50% of the total amount and low offers have about a 50% chance of being rejected. One interpretation is that behaviour guided by the social norm of reciprocity, which induces a generous division of money, and behaviour guided by the utilitarian norms of the market are mutually exclusive. If the amount received by the Proposer is perceived as a gift and not as a means for a market transaction, as Cristina Bicchieri suggests (2006, pp. 113-114), the behaviour based on the social norm excludes utilitarian conduct.

Behaviours in customer and labour markets are often judged on the basis of norms of fairness, and not those of the market. In a survey conducted on randomly selected residents of Toronto and Vancouver, Kahneman, Knetsch, and Thaler (1986) discovered that 82% of the respondents regarded as unfair the hypothetical behaviour of a hardware store which raised the price of snow shovels after a blizzard. A price increase would have been considered acceptable if it had reflected a real cost increase, but not as a mere response to scarcity. The conduct reflecting a social norm of fairness is incompatible with the utilitarian behaviour of the market, because taking advantage of the increase in demand associated with a particular

contingency is simply perceived as unfair. Therefore, behaviours which adhere to the formal norms of the market and to the social norms of fairness respectively are perceived as mutually exclusive.

**The question is this: what** links the different approaches adopted by scholars of social problems (Titmuss), psychologists (Deci and colleagues), philosophers of the social sciences (Elster), economists (Frey and colleagues), experimental economists, economic psychologists (Ariely) and behavioural economists (Kahneman and colleagues)? In my view, they intersect because they provide material of different kinds that may be reorganized within a new perspective that points to a peculiar form of conflict between the market-formal and social norms encapsulated by the expression “mutual exclusiveness”. However, they do not advance a theory on the relationships between formal and informal **norms; even** less do they share methods, aims and perspectives.

## 5. Conclusion

In recent decades, many disciplines have studied formal and informal norms, and many approaches within each discipline have developed different theories. The result is a fragmentation due to two factors: 1) different tools are used in these analyses; 2) these analyses either consider local aspects or explore only partial dimensions of the problem without putting forward an overarching theory. **Whence** derives the attempt made in this paper to develop a unitary framework in which to examine these matters. For this purpose, a conceptual framework has been proposed that would include some of the analytical results highlighted by those approaches. This operation is not without its theoretical consequences because, when analytical results produced in various contexts are included in a new framework, they acquire meanings that they do not exhibit in their original contexts, for the simple reason that they are reinterpreted and reorganized in the light of the new frame of reference.

More in detail, the interpretation put forward in this paper consists in the identification of two principles (in their turn divided into two sub-categories) able to represent the fundamental relationships between formal and social norms, i.e. complementarity and conflict. The adoption of complementarity and conflict as criteria to evaluate how formal and social norms relate to each other has necessitated a discussion about the theoretical legitimacy of this choice. This discussion is methodological in that the paper tries to explain why these criteria and not others are suitable for the analysis of the topic dealt with here. The outcome is a representation of the relations between social and formal norms which can be summarised as follows. Formal and social norms constitute different systems of social coordination. If they

cooperate, they are in a relationship of complementarity. This latter can assume two forms (i.e., C1 and C2 complementarity). When the two types of norm cover contiguous areas, and a function performed by one of them can be performed by the other, this condition (which I call 'strict homogeneity') allows in principle for one norm to erode and to replace the other. This is type C1 complementarity, illustrated by considering how legal and market norms replace specific functions previously exercised by social norms. However, other functions performed by social norms, which implement cooperation with formal-legal norms, are neither erodible nor replaceable. This situation comprises type C2 complementarity. It involves not only aspects of social norms which cannot be eroded but also social conventions which cannot be replaced by formal prescriptions.

Social and formal norms can be antagonistic. In particular, the relationships of conflict can assume two forms: 'prohibition' and 'mutual exclusiveness'. 'Prohibition' means that one kind of norm tends to suppress or alter the other. Legal norms tend to suppress or alter social norms which are at the basis of behaviours that engender racial, gender or religious discrimination, or practices such as duelling, or illegal markets. 'Mutual exclusiveness' implies that one type of norm crowds out the other. In this case, the two kinds of norm are alternatives, and adoption of one prevents (but does not prohibit) adoption of the other. Therefore, individuals choose the norm that they consider more appropriate. In short, two forms of complementarity and two forms of conflict characterise the connections between the two kinds of norms, both in many dimensions of social life and – more specifically – in the economic sphere, where the formal dimension of the market interacts with informal behaviours.

This conceptual framework differs from those **in the current** literature for a number of reasons. The most evident is that existing studies do not sufficiently discuss the concepts of complementarity and conflict. **Although these notions are** logically or descriptively involved in these approaches, **they are infrequently** mentioned, if at all. Hayek's and North's theories do not use (at least not in a satisfactory manner) the notions of complementarity and conflict, although some of the problems that they address can be reformulated **in light of** these concepts. Karl Polanyi's perspective is compatible with concepts of complementarity and conflict, although he does not employ these terms. However, he adopts a substantivist-institutional perspective (see Adaman and Madra 2002, pp. 1045-1051) which is better able to delineate the relationships between the market and social domains than views which refer to methodological individualism. Existing typologies mainly concern institutional systems, also in comparative terms. **Unlike in** this paper, they focus on relations between formal and informal institutions, rather than formal and informal norms as components of institutions. Although they shed light on many institutional phenomena, they do not adequately examine the criteria on which they are constructed, which leads to a formulation of taxonomies in which the description of empirical cases prevails over the theoretical examination of concepts adopted to explain them. One consequence of this shortcoming is that some of

these criteria could be reformulated and simplified by considering the various features of complementarity and conflict, ultimately by using the classification proposed here. More generally, as regards the interpretation of the relationships between formal and informal norms in terms of complementarity and conflict, I suggest that C1 complementarity would make it possible to reformulate the idea, developed in **both** evolutionary and historical approaches (see section 2), that formal norms **arise** from informal norms (sub-section 3.1). My approach also shows how C2 complementarity can reframe the concepts of ‘expressive dimension’ and ‘social meaning’ in social norms, and **how it helps in interpreting** the place and role of particular social norms and conventions (sub-section 3.2). As regards the economic sphere, the use of C1 complementarity suggests a perspective by means of which a variety of phenomena could be investigated, from labour contracts to the introduction of particular fines in situations jointly regulated by social norms and the formal norms of the market (sub-section 4.1). The notion of mutual exclusiveness may help **in evaluating** how in the economic sphere the formal market norms crowd out social norms in many circumstances (sub-section 4.2). Complementarity and conflict also reorganize some of the ideas – such as that of “intrinsic motivation” or that involved in the Ultimatum Game – put forward in studies on economic psychology, and on behavioural and experimental economics (sub-section 4.2).

Finally, if the notions of complementarity and conflict are criteria **useful for** conceptualising the relationships between formal and informal norms, they should not simply be interpreted as boxes in which an indefinite number of empirical cases might be included in the manner of a Linnaean entomologist when confronted with an unknown insect. By contrast, this **paper suggests** the use of these criteria to explore the nature of formal and informal norms, to study their features, to discover the logic governing their relationships, and only then to propose a possible classification.

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