2 Private enforcement of law

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1. Introduction

Polinsky and Shavell in Chapter 1 define public enforcement as the use of government agents to detect and sanction violators of legal rules. These agents include inspectors, tax auditors, police, regulators, and prosecutors. This chapter complements their analysis by focusing on the study of private enforcement of law, defined as follows:

Private enforcement allows for private persons or organizations to sanction violators of legal rules in courts without consent or action by public enforcers (such as the police, public prosecutors, or regulators). Private enforcers include the victims of offences, as well as the legal representatives of their claims.

Private enforcement is an integral part of policy debates on socio-economic problems ranging from the application of human rights codes, mitigation of environmental hazards, to the regulation of anticompetitive practices. This chapter studies how economic theorists describe private enforcement procedures and institutions, how they differ from public enforcement, and how they can contribute to the efficient implementation of legal rules.

The ‘economic approach’ to the study of law pioneered by Becker (1968, 1993) emphasizes that systems of public enforcement tend to coexist with procedures for private enforcement. Even in jurisdictions with highly competent and sophisticated bureaucracies, victims often search for alternative rights of access to courts or other independent adjudication venues to seek remedies. Typically, private access rights exist along with public responsibilities and prosecutorial discretion to enforce legal rules, for instance in the case of bid rigging or price fixing without prior disclosure, or in the presence of civil claims for sexual assault or abuse. Access by non-state entities to enforce legal rules and prosecute offenders also requires the presence of a court system and other necessary public infrastructure for implementing judgments.

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In this context, victims of injustice face a delegation problem when trying to make a claim, enforce legal rules, and punish offenders. In the case of public enforcement, the problem involves providing information to government agents with the authority to determine if the case merits further investments. With private enforcement, the victim, or her lawyer, must make the necessary investments instead. Government agents in the form of judges can of course refuse private access rights by a victim to the public judicial infrastructure, as can public prosecutors and regulators (based on evidentiary, economical, or ideological reasons) in the case of public enforcement.

Naturally, victims would typically want to defray the costs of legal enforcement and deterrence to the public sector. This is especially true if the victims are poor, and the offenders either too rich or too poor, and hence difficult to punish by the victims or their private representatives (judgment proof). Furthermore, the public sector can exhibit economies of scale and scope, and thus cost savings in the implementation of legal rules compared to a private system prone to duplication and coordination problems. On the other hand, reaching a certain threshold in terms of the size and complexity of a jurisdiction, the informational benefits of decentralization may weigh more heavily in favour of private rather than public enforcement (Fearon and Busch, 2006). Hence, smaller jurisdictions may have good financial reasons to assign exclusive rights to enforce legal rules to public inspectors and prosecutors, and pay for the deterrence through the general tax pool, while larger jurisdictions may adopt a mixed public-private enforcement system. Nevertheless, the economic approach suggests that, even in the presence of benevolent public agents, budget and information requirements of public enforcement ration the ‘rule of law’ in jurisdictions that do not provide sufficient scope for private legal actions by victims. For economists, pecuniary legal claims that function independently of the incentives and resources of government agents represent a ‘high powered’ incentive scheme that may remedy the expected inadequacies of a centralized public enforcement system (Weber, 1946; Aghion and Tirole, 1997).

Effective implementation of formal legal rights and prohibitions requires investments in funds to acquire information, prosecute offences, and punish the convicted. The financial problem exists regardless of the substantive norms under consideration, whether the application of human rights codes, mitigation of environmental hazards, trading of corporate securities, or the regulation of anticompetitive practices. The required investment can be made through public agents such as state prosecutors or regulators. Importantly, even the most well-intentioned and informed regulators, prosecutors, or judges depend upon the cooperation of either
victims of crime or knowledgeable informants to complete their tasks. In case of enforcement rationing and low deterrence levels by a centralized public enforcement system, the responsibility for investigation, prosecution, and punishment will fall on the victims or their representatives. The key difference between public and private enforcement consequently lies in the availability of a procedural option for victims and their representatives to access the public judicial infrastructure in search of compensatory remedies without consent, action, or investment by agents of the state, such as prosecutors, inspectors, regulators, or administrators.

As detailed long ago by Weber (1946), and formalized more recently by Aghion and Tirole (1997), public agents are typically paid fixed salaries, generating the possibility that they will have 'low powered' incentives to implement the formal authority of the law. Private enforcers, on the other hand, seek pecuniary legal claims, or the 'bounty'. Mookherjee (2006) provides a review of the economic literature on the design of mechanisms for controlling principal-agent problems characterized by low-powered incentives in hierarchical organizations that arise because of a separation of ownership and control.

Drew (1995) characterizes private enforcement in modern legal thought as ultimately deriving from legal mechanisms which existed prior to the centralization of power by monarchies in Europe during the Middle Ages. With the rise of republicanism in the 18th century, the clan-based and feudal regimes for enforcement of contract and property law were gradually superseded by codified statutes and centralized administrative agencies in most of continental Europe. The evolution of legal procedures in England differed somewhat from the European trends due to the increased use of private prosecutors. Friedman (1996) explores this historical anomaly, and attributes its formation to the profit motive of the monarchy. However, as it became increasingly problematic in the English bounty system to control the urban populations, the regime was abandoned and replaced by public policing and prosecution agencies in the 19th century.

In the United States, private systems for the regulation of liability, from industrial accidents to anticompetitive practices, operated for most of the 19th century. Glaeser and Shleifer (2003) argue that the adoption of the new technologies that relied on economies of scale and the institution of limited liability enhanced the asymmetries among potential victims and offenders, motivating the 'rise of the regulatory state'.

Expanding the powers of public prosecutors and administrators to detect and sanction violators of legal rules outside Western Europe and North America was typically a product of colonial efforts to subdue local populations. A large body of research reviewed by Wolf (1982) and
Merry (1992) has studied the co-evolution of colonial and local regulatory regimes.

The inefficiencies associated with the public enforcement of trade regulations were criticized by the forerunners of modern economic thought. For instance, the Physiocrats in the French court focused on the perverse incentives created by the enforcement of monopoly rights granted by the monarchy, while authors of the Scottish Enlightenment like Adam Smith pointed out the costs of trade regulations on local and colonized economies (Smith, 1776; Landreth and Colander, 2002). Liberal thinkers stressed the potential unintended consequences of the exercise of centralized political authority to regulate socio-economic behaviour. Thomas Malthus (1800), on the other hand, blamed the private rights of access by the indigent to common law courts as the cause of ‘The High Price of Provisions’.

Economists of the late 19th and early 20th centuries often found the liberal appeals to private systems of regulation to be ‘unscientific’ and instead followed the Malthusian tradition. Clark (1894), an influential figure in the development of economic analysis in the United States, for instance categorized appeals to law to organize economic processes into ‘anarchist’ and ‘socialist’ groups, and dismissed attempts to limit the powers of the state as ‘self terminating’. In the German-speaking world, scholars such as Eugen von Böhm-Bawerk (1851–1914) and Max Weber (1864–1920) developed bodies of systematic evidence about modern and pre-modern legal systems. Contemporary studies in law and economics combine the formalist and empiricist methodologies to describe and analyze features of real legal systems (see Williamson, 2000; Greif, 1998, 2005).

The framework for most formal rational choice models follows from the seminal study by Becker (1968) on the ‘economic approach’ to the study of crime and punishment. In his analysis, the institution of private enforcement functions as a theoretical construct (ideal type in the language of the empirical or ‘historical’ school in the German language tradition). The theoretical ideal serves as a benchmark for the analysis of public legal systems. Consequently, what we call ‘first generation’ models in this chapter implicitly assume that the two distinct mechanisms function as substitutable institutions, potentially able to completely replace each other (see Gerschenkron, 1962, for the seminal introduction of this concept in his historical criticism of deterministic Marxian models of economic history). Hence, the adoption of one negates the need for another in this class of models. More recently, some researchers have instead characterized private enforcement as an instrument that complements the resources and information available to the public and enhances the credibility of legal rules present in statutes and precedent (see Aoki, 1994, for an analysis of
institutional complementarities in terms of contingent delegation of tasks to public and private bureaucracies). The ‘second generation’ models view law and regulation as mechanisms that can replicate ‘missing markets’, or as insurance against undesirable states of the world (Laffont, 2000, 2005).

Ahead of detailing the rich distinctions within the economic models of enforcement, it is imperative to highlight their similarities in terms of the ‘economic approach’ to the study of behaviour (Becker, 1993). In both classes of models, private enforcement of the law serves as a proxy for a system of regulation where all individual interactions are monetized, and both individuals and groups rationally exchange rights and privileges, compensating each other for the consequences of their actions. In this view, legal institutions function analogously to a Pigouvian tax system on negative externalities (for example, pollution). The tax punishes socially undesirable behaviour by imposing small fines applied frequently, instead of resorting to heavy but infrequent criminal sanctions. The next section looks at the historical origins of problems that motivated this analytical dichotomy between public and private enforcement procedures. Section 3 reviews theories that describe the two enforcement mechanisms as institutional substitutes, while Section 4 looks at models that emphasize complementarities between actions by public and private enforcers. Section 5 concludes by presenting a number of specific applications of the economic approach to the study of enforcement mechanisms. An extended reference section follows, with suggestions for further reading.

2. The crime-tort puzzle

Becker (1968) provides an exploration of crime and punishment using the usual tools for the analysis of industrial organization. His application of marginal analysis shows that legal systems that impose small but frequent punishments are superior to those that tend to deploy ‘hang them all’ strategies (with heavy, but infrequent punishments) for inducing compliance with the law. Moreover, Becker (1968) demonstrates that budget-maximizing behaviour of public enforcers encourages the adoption of ‘hang them all’ strategies promoted famously by Jeremy Bentham (1789) in his *Introduction to the Principles of Morals and Legislation* aimed at preventing vice and promoting virtue. Fyodor Dostoevsky (1821–1881) criticized the usefulness of heavy punishments due to the perverse economic incentives they create in offenders, enforcers, and victims. The economic approach uses the instruments of formal modelling, and more recently empirical testing, to study these perverse incentives and design efficient mechanisms for implementing legal rules.

In the ideal type of private enforcement system implicitly underlying most economic models, a price system generates a stable equilibrium
level of illegal activity. Moreover, the theory assumes that the marginal expected utility calculation of potential offenders determines the level of expected offences. Consequently, rational criminals commit offences as long as they believe that the marginal expected private benefits from their actions are greater than the expected costs of punishment. The primary variables considered by offenders in the Becker (1968) model are the probability of apprehension and conviction, and the potential punishment if convicted. Two distinct trends in the development of US legal institutions shortly after World War II explain the choice of variables, model structure, and the puzzle raised in this chapter.

2.1 Criminalization

In some areas of crime and punishment, the evolution of the US system contradicts the prediction of price theory that economic considerations should stimulate the formation of efficient systems of enforcement that equate the social costs and private benefits of illegal actions. Importantly, Becker’s (1968) analysis appears to be inspired both by a concern for the increased criminalization of a wide range of activities, and by the basic observation that criminal law typically involved heavy punishments, including execution, prison terms, and the social stigma of having a criminal past. He estimated that, as of 1965, 2 per cent of the US labour force was already in prison, on parole, or subject to the resultant restrictions on their participation in the labour market. Recent data show that the trend identified by Becker (1968) has persisted: Department of Justice statistics reveal that the number of persons in prison, on parole, or on probation in the US tripled between 1980 and 2005. As of 2005, this amounted to approximately 7 million of America’s labour force of 150 million (approximately 5 per cent of the labour force).²

As an illustration of the level of criminalization, the courts apply heavy criminal punishments for numerous non-violent offences, for example illegal drug possession or prostitution. Economists usually do not view these crimes as socially costly. Moreover, US courts have handed down heavy sentences to young offenders (who are deemed incompetent to form requisite criminal intent in most other jurisdictions) with increasing consistency. The persistence of heavy criminal punishments in the US and some developing country jurisdictions remains puzzling to observers who apply the fundamental methods of price theory to the analysis of legal institutions. Friedman (1999, 2000) observed that, even if we ignore

the immorality of execution, torture, or imprisoning people for extended periods of time, economic considerations reveal that such harsh punishments are inefficient relative to private enforcement alternatives that principally apply smaller, but more frequent punishments in terms of fines:

Replacing a criminal punishment with another that both is more severe and has a lower ratio of punishment costs to amount of punishment while reducing the probability of conviction to maintain the same level of deterrence, lowers both punishment cost and enforcement cost. Hence, imprisonment is always dominated by execution and both are dominated by fines and other alternatives. Modern legal systems do not fit that pattern. (Friedman, 1999, p. 259)

Although some legal systems continue to utilize execution and long-term imprisonment liberally, many other jurisdictions have moved away from these forms of punishment and switched to fines and other alternatives. Prominent examples of this transition include Western Europe, Japan, and Canada after World War II, Latin America and Eastern Europe after the political changes of the 1980s and 1990s, and South Africa following apartheid. The new lawmakers in these jurisdictions did not preserve their sovereign rights to engage in execution, torture, and long imprisonment for non-violent acts in order to control the population. These states have instead increasingly instituted economic control through taxes and administrative regulations, and have not retained the heavy criminal punishments readily available under previous regimes. For violent offences, although imprisonment remains as an effective solution, these jurisdictions also abolished execution, an important symbolic gesture in the choice of punishment strategies. Hence, many modern legal systems have started to converge towards the patterns of institutional change suggested by price theory.

This observation justifies the need to separate the analysis of enforcement along two classes of models. The methodology of the first generation of models implies that public and private enforcement institutions could replace each other in practice. In other words, this theory assumes that public and private enforcement mechanisms are substitutable processes for the enforcement of law, and the presence of one negates the power of the other. A crucial assumption on which this result rests is that orthodox theory of optimal punishment ‘treats the enforcement apparatus – police, courts, prosecutors, and legislature – as a philosopher-king, with imperfect knowledge but only the best of motives’ (Friedman, 1999, p. 262). Hence, if there is a divergence of incentives between public enforcers and victims (or their representatives) due to political or financial motives, we cannot expect the outcomes under public and private enforcement to be identical.
In reality, we often see a mix of private and public prohibitions applied to remedy similar or related behaviour. Different entities, including the victims and offenders, their representatives, public prosecutors, or even the news media, get involved in gathering information about illegal practices. In case of sufficient grounds for a legal claim, the public or private prosecutors then must invest their funds and efforts in prosecution and punishment of offenders. Second-generation models explore how private access rights function to enhance the inherently limited capacity of public regulatory institutions to channel information necessary to identify and prosecute offences.

### 2.2 Privatization

Although choices made regarding criminal law procedures and punishments in the United States did not follow the predictions of price theory, a second broad trend in the development of legal procedures in the US is readily explained, and justified, by the analysis of Becker (1968). Following World War II, criminalization coincided with the radical and rapid expansion of private rights of standing in courts to claim civil liability based on a wide range of norms and statutes. Specifically, private claims were allowed in the regulation of civil rights, labour market practices, environmental monitoring, securities regulation, and antitrust. The new enforcement regimes meant that victims had the option of directly prosecuting offenders, as long as they could convince a lower court judge of the merits of their case. Victims hence did not have to seek the approval of public prosecutors or other administrative agencies in their pursuit of pecuniary claims.

The procedures adopted to enforce the laws, however, did not eliminate the role of the government, but simply changed the channels for communication of information from potential victims to bypass the police, inspectors, and public prosecution offices. In the case of civil rights, a well-documented popular hostility to the laws of the central government in some regions meant that public enforcement lacked credibility. Nevertheless, government agencies at all levels remained active in developing standards for the implementation of the new Federal legislative mandates. Moreover, the radical expansion of cases was supported by increased investments in courts and training of the judiciary, as well as bailiffs, sheriffs, and court-appointed creditors that implement civil judgments. Private enforcement mechanisms hence did not replace the public sector, but instead enhanced the government’s credibility by giving its legislation more ubiquitous authority.

As an important illustration, consider the case of enforcement of public antitrust/competition laws, which is a task delegated almost exclusively to national competition bureaus or antimonopoly agencies in most
jurisdictions, with the notable exception of the United States. When the Clayton Act was passed in 1914, citizens and other legal entities were granted the right to enforce provisions of the Sherman Act through civil actions, and claim triple the actual damages. Public enforcement since the adoption of the Sherman Act had been highly erratic, and it was almost completely abandoned in the early 1930s as the Federal government started to adopt policies aimed at stimulating agglomeration and cartelization (Cole and Ohanian, 2004). Private actions were nonetheless rare before World War II, despite the formal legislative mandate established by the Clayton Act of 1914.

Following World War II, there was a rapid transition from a primarily public enforcement approach to one relying principally upon knowledge and investments by private enforcers. The reason for this transition in choice of legal procedure remains a mystery for US antitrust historians. Records of the Administrative Office of the US Courts document that the ratio of civil cases filed by private claimants to those initiated by public prosecutors increased from approximately 1:1 in 1945 to 10:1 by the 1970s before stabilizing at around 7:1 in the 1980s and 1990s. Moreover, as documented by Salop and White (1986), the private claimants were typically downstream firms and competitors of the offenders. These entities are likely to have more detailed and accurate knowledge about what constitutes anticompetitive practices in specific industries, and often have commercial incentives other than the expected damages to stop them. Despite the availability of a damage multiplier and relatively lax rules for the formation of class actions, their data suggested that final consumers did not play a significant part in the enforcement process. This observation potentially highlights the difficulties in employing private enforcement mechanisms, when the benefits of a particular offence are concentrated, and their costs dispersed across a large population facing high coordination costs to engage in collective action through the courts. Due to the asymmetry in organizational ability, and hence also financial means, to engage in legal action on the part of consumers, private enforcement must be viewed as a high-powered mechanism for the acquisition of information that complements public regulatory institutions.

By the 1970s, the trend towards greater rights of access to courts generated a good deal of political resistance by the usual suspects, including industrial and professional service/labour lobby groups involved in a movement now colloquially called ‘tort reform’ in the United States. In addition to groups that expected to lose from the emergent enforcement procedures, private actions faced significant resistance from lawyers and economists associated with Federal Courts and antitrust bureaucracy. As documented by Breit and Elzinga (1985), despite their many differences on
the desirability of horizontal and vertical collusion, the so-called Chicago and Harvard schools of antitrust thought of the late 1970s and 1980s vehemently opposed private standing rights before the courts. This normative consensus stands in sharp contrast to the results obtained by Becker (1968, p. 199) in his application of the usual price-theoretical framework for the analysis of industries to the study of enforcement institutions:

If compensation were stressed, the main purpose of legal proceedings would be to levy fines equal to the harm inflicted on society by constraints of trade. There would be no point to cease and desist orders, imprisonment, ridicule, or dissolution of companies. If economists’ theory about monopoly is correct, and if optimal fines were levied, firms would automatically cease any constraints of trade, because the gain to them would be less than the harm they cause and thus less than the fines expected. On the other hand, if Schumpeter and other critics are correct, and certain constraints of trade raise the level of economic welfare, fines could fully compensate society for the harm done, and yet some constraints would not cease, because the gain to participants would exceed the harm to others.

Becker’s (1968) arguments were purely theoretical and did not recognize the emergence of a private enforcement system in the US after World War II. Since the early 1980s, many other jurisdictions in Europe, Latin America, and Asia have adopted competition laws that aim to regulate restrictive trading practice (for example, collusion without disclosure) in their emerging market economies (Palím, 1998). Although these jurisdictions often replicated the substantive elements of the Sherman Antitrust tradition, almost none has managed to develop a regime that accommodates private actions by victims. Consequently, similar legal rules are enforced through radically different procedures, motivating appeals to private rights of action by both local and foreign entities in courts. In many cases, private actions are not possible, despite repeated manifestation of such rights in formal laws. Examples of the existing wedge between formal legal and real political authority in the area of competition law can be found in Brazil (Gidi, 2003), Canada (Roach and Trebilcock, 1996), and in the member states of the European Union (European Commission, Ashurst Report).  

The widely quoted decision by the European Court of Justice (ECJ) in Courage v. Crehan summarizes the economic arguments for employing private enforcement mechanisms, in this case to enhance the authority of existing agreements among the member states of the European Union:

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The full effectiveness of Article [81] of the Treaty and, in particular, the practical effect of the prohibition laid down in Article [81(1)] would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition.

Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community.4

The particular justification used by the ECJ for supporting private access rights through local judiciaries highlights the point of departure of the second-generation models in Section 4 that describe public and private enforcement as potentially complementary mechanisms. Significantly, the argument by the ECJ does not suggest that private actions are desirable because they save the state financial expenditures on enforcement. The ECJ justifies private enforcement with the presumption that information about practices that threaten inter-state legal commitments are costly to acquire and disseminate, and especially so for a public bureaucracy. In stark contrast to the ECJ’s opinion stands Landes and Posner’s (1975) pessimistic characterization of private access rights as a form of ‘blackmail’. In both theories though, private enforcement institutions serve to convey information that would otherwise be unavailable to the public.

3. First-generation models of private enforcement

Coase (1960) criticized the manner in which economists and other social scientists characterized the notion of social cost from the top-down perspective of a benevolent state (Cooter and Ulen, 2004, p. 96). To remedy the problem, he constructed a bottom-up view of legal institutions and economic behaviour comprised of two general classes of mechanisms used to regulate socio-economic behaviour. Liability regimes employ adjudication venues such as courts after a harmful act has taken place, as well as public standards of precautionary care. Hence, liability allows for bargaining between offenders and their victims over the distribution of the costs and benefits of an action after victims and offenders have observed some information about the actual level of harm. Usually, negotiations take place before a case is filed with the public courts or with private arbitrators, based on the expectations the parties have formed about

4 Case C-453/99. Emphasis added. For a critique of efforts to implement private access rights in the European Union jurisdictions, see Depoorter and Parisi (2005).
the costs and benefits of adversarial litigation. In case bargaining in this bilateral setting fails, a court could take on the case, collect and verify information about the level of harm from the offence, judge if the evidence shows a violation of applicable standards, and determine the punishment. A fundamentally different approach to instituting legal authority are property regimes, which comprise ‘bright line’ rule (versus liability standards) and heavy punishments against violators of the prohibitions. Easy to interpret and costly sanctions motivate stronger commitments to negotiations prior to a potentially risky act than liability regimes relying on monetary compensations. For property regimes to function efficiently, the transaction costs of exchanging usage and exclusion rights must be sufficiently low. Since transaction costs are generally positive, a residual role remains within this framework for liability regimes that monetize compensation and encourage negotiations between victims and offenders after the act.

Becker (1968) argued that the central variable in determining the level of offences are the resources devoted to control by police, courts, and prisons. Higher expenditures increase the probability of detection, apprehension, conviction, and punishment of wrongdoers. Punishments are assumed to take on the form of fines or imprisonment.

Becker (1968, p. 198) argued that

... if the case for fines were accepted, and punishment by optimal fines became the norm, the traditional approach to criminal law would have to be significantly modified. First and foremost, the primary aim of all legal proceedings would become the same: not punishment or deterrence, but simply the assessment of the ‘harm’ done by defendants. ... A criminal action would be defined fundamentally not by the nature of the action but by the inability of a person to compensate for the ‘harm’ that he caused. Thus an action would be ‘criminal’ precisely because it results in uncompensated ‘harm’ to others. Criminal law would cover all such actions, while tort law would cover all other (civil) actions.

Becker and Stigler (1974) focus on the interactions between public enforcers and potential offenders and highlight the possibility of perverse incentives in public enforcement systems. They show that higher punishments induce rent-seeking behaviour in a centralized enforcement agency and may lead to collusion and/or cooperation between enforcers and criminals to split the punishment from illegal actions, defined generally in terms of a fine. This trade can take place explicitly through cash bribes. Alternatively, the collusion can be implicit, for instance based on a promise of future employment by the offender to the public employees. Administrative improvements and political control will only partially mitigate the problem.
The possibility of Coasian bargaining (Cooter and Ulen, 2004, p. 74) between enforcers and offenders is of course also present in a private litigation system as the parties reach a settlement. However, the limitations of public and private enforcement systems manifest themselves under different conditions: Public enforcement will tend to be less effective in terms of punishment and deterrence when offenders have sufficient resources to bribe public officials. On the other hand, offenders who are poor, or have gained little from their crimes, will have little to share with government agents, and thus public enforcement is likely to be more effective in such cases. The standard solution to the incentive problem by public agents is to simply add more levels of public enforcers within a hierarchy to monitor each other. This top-down monitoring solution allows supervisors to control the communications and transactions by the police, prosecutors, or industry regulators better than a flatter organizational structure.

As bottom-up monitoring through private actions became more popular in the United States, Landes and Posner (1975) retorted to Becker and Stigler’s (1974) justification for private access rights as a means to enforce public norms. The argument by Landes and Posner (1975) focused on the actual distribution of enforcement activities between public prosecutors and private litigants in the US legal system. They assume/hypothesize that common law institutions should be able to learn to adopt efficient procedures over time, thus assigning enforcement responsibility to public and private actors based on their capacities. They ask a question that goes against the grain of the standard economic framework: If private enforcement is always more efficient, why do we see so many appeals to public enforcers when a law is broken? Public enforcers are regularly called upon to control violent crimes, environmental infractions, or trust law violations. Indeed, why would any community resort to public enforcement if it were such an inefficient procedure for detecting and punishing offenders of legal rules?

Landes and Posner (1975) conjectured that a private system is more efficient for offences detected and punished at near zero costs, such as contract or property offences, whereas a public system should be utilized for offences that are hard to detect and punish. Their arguments against the value of extending private enforcement include: (a) the impossibility of constructing legal rules that give victims optimal incentives to prosecute, (b) the prospects for scale economies in public enforcement, and (c) the potential for the tragedy of commons if private enforcers have access to a publicly subsidized judicial infrastructure.

Part (a) of the Landes-Posner (1975) impossibility theorem conjectures that once an amount of punishment is set in a system of private
prosecutions, there is no way to control the probability of punishment. With predefined punishments, the profit-maximizing behaviour of private litigants will drive the level of punishment. Given the tragedy of commons considered under part (c), public subsidies to courts lead to over-enforcement and over-deterrence. On the other hand, public enforcement does not lead to the same perverse incentives. The primary intuition for this result is the important observation that public prosecutors have great discretion and power to decide which rules to integrate into legal practice, and hence which offences are punished and deterred. The discretion allows government agents to avoid enforcing inefficient and/or unjust laws in courts subsidized by the tax pool, as in the traditional commons tragedy argument. The behaviour of private litigants consequently would be much harder to control when victims or their legal agents access the judicial infrastructure. Probably the most evocative critique of the economic approach is that which labels private enforcement as ‘blackmail’:

Were blackmail, a form of private enforcement, lawful, the public monopoly of enforcement would be undermined. Over-enforcement of the law would result if the blackmailer were able to extract the full fine from the offender . . . Alternatively, the blackmailer might sell his incriminating information to the offender for a price lower than the statutory cost of punishment to the criminal, which would reduce the effective cost of punishment to the criminal below the level set by the legislature. (Landes and Posner, 1975, p. 42)

Becker and Stigler (1974) had argued that public agents have perverse incentives in interpreting and punishing offences, specifically because they tend to apply harsh punishment to offenders whose actions cause little social harm, and cooperate with those entities engaged in more harmful acts. The actual level of enforcement then can deviate from the social optimum in an idiosyncratic manner. Landes and Posner (1975) contribute to the discussion by pointing out that actions by private persons or organizations in search of pecuniary claims under a private regime can similarly lead to such deviations. The analogy of ‘blackmail’ nonetheless also captures the idea that private enforcers can have ‘high powered’ incentives to enforce the law. This notion supports the hypothesis that information about offences with potentially significant social costs may remain secret in the absence of private rights of standing before the courts.

Notably, this characterization of private enforcement as a mechanism for the acquisition and dissemination of information appears similar to the opinion of the European Court of Justice decision in Courage v. Crehan, detailed earlier in the case of prohibitions against anticompetitive practices that constrain the application of treaty obligations among European Union member states. In contrast to the ECJ of the late 1990s, however,
Landes and Posner (1975) clearly believe that revealing information about illegal practices using private enforcement limits the efficient application of legal rules and sanctioning of offenders. Breit and Elzinga (1985) show that the aversion to private access rights shown by Landes and Posner (1975) was quickly accepted by antitrust analysts with strong historical associations to the US Federal government (for example, the so-called Harvard and Chicago schools of thought).

Friedman (1984) offers an elegant and readily tractable treatment of the criticism of the economic approach offered by Landes and Posner (1975), specifically with respect to the ‘over-enforcement’ hypothesis claimed in the case of private enforcement. He notes that the Landes and Posner (1975) results follow directly from their assumptions that: (a) only monetary punishments are possible, (b) courts simply impose the maximum fine, and (c) the collection of fines is costless. Friedman (1984) points out that a more general and realistic approach would account for the idea that collection costs (including litigation costs) tend to be an increasing function of the expected punishments that offenders face.

For Landes and Posner (1975), punishment represented both a disincentive to the criminal, and an incentive to the private enforcer, not accounting for the costs associated with the collection of a punishment. This meant that the same variable would determine two parameters of their models, generating the ‘impossibility theorem’ and suggesting that an ideal system of private enforcement will always be inferior to a public one that allows for public prosecutorial discretion. Expected and actual punishments are typically ‘decoupled’ in legal systems, for instance in jurisdictions where private claimants have to incur the costs of collecting the fine. When collection costs increase with the level of punishments imposed on offenders, private enforcers have incentives not to over-enforce, and hence over-deter, offences. Indeed, as the example of antitrust litigation in the US showed, private enforcers may face excessively weak incentives to prosecute entities that are asymmetrically resourceful relative to their victims, requiring a damage multiplier to motivate private actions. Easing procedures for the formation of class actions by victims is another method for increasing the efficacy of private enforcement mechanisms when there are significant asymmetries in the collective action capacities of offenders and victims.

Friedman (1984) further claims that the assumption that collection costs increase with expected punishments accentuates the results by Becker and Stigler (1974) about the perverse incentives for public enforcers to target actions with relatively little social harm, and cooperate/collude with entities engaged in more costly practices. The fact that such perverse incentives can also arise under private enforcement systems that employ "hang
them all strategies’ for punishing offenders was not incorporated into Friedman’s (1984) model. For instance, the People’s courts of revolutionary Soviet Union and China were forums that used private information and prosecution, as well as heavy punishments, to sanction violators of legal rules. Friedman (1999) addresses this problem by highlighting the infamous use of financially motivated private enforcers in Imperial Britain in the 18th century to prosecute or deport offenders of minor crimes to overseas colonies, as well as the possibility that excessive tort liability can lead to the demise of useful industries.

Garoupa and Klerman (2002) build on the suggestion by Friedman (1999) that economic models have failed to adequately detail the incentives of enforcers. Specifically, they relax the orthodox assumption that public enforcers act in a benevolent manner, and explore how the presence of rent-seeking behaviour by agents of the government influences the standard results from the Becker-Friedman model. Their analysis suggests that if offenders have sufficient wealth, rent-seeking public enforcers discourage minor crimes more aggressively than a social welfare-maximizing government, and are less attentive to crimes with potentially large social costs. Similarly, competitive private enforcement is always at least as good as monopolistic private enforcement. Competitive private enforcement is, however, typically inferior to public enforcement when the level of harm is very high or when public enforcement has a cost advantage. Garoupa and Jellal (2002) model the presence of an agency problem between government and the enforcement agency. They show that if raising public funds is very costly, private enforcement could be superior to public enforcement, an insight of particular importance in the design of legal institutions in developing countries.

Further imperfections that are likely to affect the comparisons between public and private enforcement include, for example, victims of an offence facing resource constraints. When capital markets are inefficient, victims, or their legal agents, cannot borrow against their legal claims, leading to under-enforcement in private systems. This critique builds on historical insights from the era of modern industrialization in Western Europe and the Americas. As described by Polanyi (1944) and Glaeser and Shleifer (2003), technological innovation and economies of scale led to significant inequalities in resources, and thus limited the efficacy of a decentralized system that organized property and liability.

Similarly, injury to victims can be diffuse, resulting in collective action problems in organizing and uniting resources needed to investigate, prosecute, and punish resourceful offenders (see Friedman, 2000).

A significant limitation of the first-generation models is that they do not account for the features of political institutions that impact on the
choice between high frequency/low punishment mechanisms of private enforcement on the one hand, and low frequency/’hang them all’ public enforcement strategies promoted by Bentham and his followers on the other. Persson and Siven (2007) address this problem by focusing on the impact of mass voting on the choice of enforcement procedures. They observe that models of crime that follow Becker (1968) typically assume that courts have an aversion to convicting people who are not guilty or making Type I errors (that is, false positives). Their analysis shows that voting pressures by citizens, who internalize the possibility that public enforcers will (falsely) investigate, prosecute, and punish them, limits the scope for maximal punishments. When the probability of wrongful conviction is large, democratic systems allow the voters to communicate their fears of wrongful conviction to lawmakers, motivating the adoption of more efficient procedures characterized by smaller, but more frequent, sanctions.

The analysis by Persson and Siven (2007) provides an explanation for the rather rapid transition from systems of heavy criminal punishment in Western Europe after World War II, Eastern Europe after the collapse of socialism, post-apartheid South Africa, and in the new democracies of Latin America since the 1980s. Top-down monitoring by public enforcers, both capitalist and socialist, generated too many false positives from a social perspective.

The adaptive (Bayesian) political economy framework of Persson and Siven (2007) suggests that when subgroups of the population are routinely targeted by the public enforcers and have little political voice, inefficient low frequency/heavy punishment strategies can be sustainable over time. When heavy punishments are concentrated on narrow population groups, for example on political dissidents, ethnic or religious minorities, ‘hang them all’ strategies persist with democratic voter support. For example, the US experience with high incarceration rates and the prevalence of ethnic minorities in convicted offenders can be explained in this context.

It should be noted that this review of first-generation models is not comprehensive and the reader should refer to the reference section at the end of this chapter for further research. For example, Polinsky (1980), Miceli (1991, 1994), and Garoupa (1997) provide different models of public versus private enforcement. Another class of research that has focused primarily on private enforcement in a historical and institutional context includes Macaulay (1963), Landa (1981), Greif (1989), Milgrom et al. (1990), Ellickson (1991), and Clay (1997).
4. **Second-generation models of private enforcement**

The models reviewed in the last section invariably viewed public and private enforcement as mechanisms that can replace each other, or function as substitutable procedures for a given type of offence. This means that the presence of one procedure negates the need for the other by assumption, motivating some observers to describe private mechanisms as a threat to the power of the state. This section focuses on models that explicitly explore the possibility that private enforcement procedures extend the authority of government under budget and informational scarcities facing bureaucratic administrations, and thus introduces the possibility of overlapping jurisdictions for a given type of offence.

As an illustration of the gap addressed by second-generation models, consider the example of environmental pollution by a subgroup of power plants in excess of the statutory or self-regulatory industry standard. Three general procedures are available for the acquisition and dissemination of information about the violations by the specific subgroup: (A) The government inspects and enforces punishment on behalf of those harmed by the pollution. (B) The state legislative bodies or the industry set the standard of care as in part (A), but private persons or organizations bring the cases to courts or negotiate with violators directly over the costs of their actions. Private litigants may be the direct victims of the negative consequences of the pollution, for example in terms of their health or property, or competing firms in the industry. The second group of litigants arguably differs from the first because of the high level of specialized knowledge that they may have gained in the course of their business. (C) Lawmakers can institute a system with overlapping jurisdictions between public and private enforcers.

Landes and Posner (1975) argued that when there are effective private rights of standing in courts, public prosecutors and administrators lose their monopoly position in choosing which laws to enforce. Without prosecutorial discretion, legal rules on the books would be over-enforced, and many actions with little social harm would be subject to blackmail by private enforcers in search of pecuniary awards. However, when public enforcers face budget and information scarcities, and victims do not have independent access to courts, offences with large social costs may go under-punished, and hence under-deterred. Indeed, public prosecutors and administrators commonly encourage ‘blackmail’, for instance by using confidential informants and leniency programmes to acquire information they need about the practices of a wide range of possible offenders.

To see the difference between first- and second-generation models, consider Rose-Ackerman (1991, p. 54) who characterizes the relationship between tort law and regulation by stressing that the ‘fundamental
differences between tort law and regulation centred not on substantive standards, or on the distribution of benefits and harms, but on procedures’. Her procedural view outlines the conditions under which the tort system complements statutory regulations. Torts and statutory regulation can be complementary when: (1) tort doctrines are stopgap measures which are applied when more stringent statutory standards are unavailable, (2) statutes are considered to reflect minimum requirements, and more strict tort doctrines are available, and (3) a regulatory standard is set at a socially optimal level, and a less strict tort standard applies (Rose-Ackerman, 1991, p. 55). However, the analysis of Rose-Ackerman (1991) does not allow for asymmetries between public and private enforcers in terms of resources, information, or incentives.

Laffont and Martimort (1998) do not directly address the problem of private enforcement, but instead emphasize the political difficulties in the implementation of ‘separation of power’ strategies, especially when they are efficient from an economic perspective. They focus on the internal organization of the government as the determinant of the ‘efficient’ allocation of regulatory rights and the design of communication channels for the acquisition of costly private information about undesirable practices. They assume that the power to ‘capture’ the government results from the presence of costly and asymmetric information between the regulators and the regulated. They show that a decentralized form of government is only good if it does not improve the communication channels between local state entities and pressure groups relative to a centralized form of government. This argument follows the belief that centralized agencies tend to be more separated from day-to-day issues concerning specific interest groups. On the other hand, decentralization improves the capacity of the regulatory system to acquire the information necessary to function efficiently.

Importantly, this approach to describing regulatory systems (also see Laffont 2000 and 2005) stresses that reorganizing regulatory power (in terms of centralization or decentralization) is not feasible precisely when it is optimal from an economic perspective. The presence of asymmetric information leads to endogenous political resistance by those who benefit from the status quo organization of regulatory rights and prohibitions. In the context of private enforcement, this conjecture provides an explanation for situations in which formal access rights to private persons or organizations exist in legislations, but judges and public prosecutors effectively block standing rights by victims. The remainder of this section reviews three different approaches offered by recent studies that extend the basic Laffont-Martimort framework to the study of private enforcement.

Hirart, Martimort and Pouyet (2004) contribute to this discussion by distinguishing between ex ante regulations and ex post litigation. Ex ante
regulation involves setting standards of precautionary care against future harm, and designing an incentive scheme that induces firms to abide by the rules. *Ex post* litigation means verification of the public standards through courts that are functionally independent from the regulatory administration. Their framework does not assume away the possibility of overlapping jurisdictions, as do first-generation models. It presumes instead that (a) firms have private information about their levels of risky behaviour with respect to third parties, and (b) the role of the public enforcers is primarily limited to setting the relevant standard of precautionary efforts. Their analysis shows that when the level of precaution by firms engaged in potentially risky activities is only imperfectly observable by the public regulators, high-risk offenders act as if they were engaged in activities with low expected social costs. Private enforcement serves as a form of co-insurance against possible risky behaviour by a subgroup of potential offenders who can easily mask the costs of their actions from external observers.

Aubert et al. (2006) focus on the differences between two alternative methods to motivating private enforcers to reveal their valuable information about offences to agents of the government. Their analysis suggests that reduced fines/leniency are less effective than positive rewards/bounties in helping the government acquire information from external sources, specifically in the area of public enforcement of antitrust/competition regulations. Positive rewards are especially important because they reduce incentives to collude before the illegal actions have taken place. Positive rewards for valuable information deter offences because members of a colluding firm must incur additional costs to hide their illegal actions internally from their own employees.

Chen (2006) offers a third approach to modelling private enforcement within the Laffont-Martimort framework by depicting private enforcement as a ‘divide and conquer’ strategy that allows a state to control the power of a bureaucracy. Inspired by the widespread use of the suggestion box in Imperial Chinese history, this analysis compares private enforcement to an open channel for communication of information about offences to the political authorities. The emperors used a suggestion box to allow information to circumvent the large and powerful ministries responsible for the day-to-day implementation of government edicts. The boxes provided the possibility of a channel for either government officials or other private persons to communicate information about illegal practices to the political elites. This possibility generated stronger incentives for compliance with the law by the offenders and constrained the discretion of mid- and low-level bureaucrats and judges who often protected resourceful criminals from investigation, prosecution, and punishment.
The analysis highlights that an effective/open communication channel for private enforcement must contain two elements: (a) a right to secret reporting so that bureaucratic intermediaries do not block the flow of information, and (b) a system of positive rewards for informants taking the trouble to reveal their valuable secrets.

In the Chen (2006) and Aubert et al. (2006) models, private enforcement is used to simply acquire more information by the state at lower costs. Government personnel consequently retain an option to block the flow of this information, either to their supervisors, or to the public. As highlighted by the ECJ in *Courage v. Crehan*, private enforcement is desirable not only because it lowers the costs of information acquisition. Courts also induce an element of separation of power in available procedures for the production of socially valuable information, hence increasing the expected costs to private interests that aim to influence regulatory decisions.

5. Some applications

5.1 Competition law/antitrust

A commonly cited application of the complementarities between public and private enforcers relates to the regulation of anticompetitive agreements and abusive practices. Post-World War II private enforcement of *per se* prohibitions against anticompetitive agreements, for instance bid rigging and price fixing in procurement contracts, became the principal mechanism for the implementation of the (long neglected) rules of the Sherman and Clayton statutes in the US. More recently, the lack of private rights of access has become an important issue in the European Union, as well as in a number of developing and transition jurisdictions that adopted competition statutes in the 1980s and 1990s. As detailed by Gidi (2003) in the case of Brazil and the Ashurst Report for member states of the European Union, even where formal standing rights for non-state actors to enforce rules against anticompetitive agreements are present, actual private actions are rare outside the United States. Further evaluations of private rights of access to competition law enforcement include Roberts (2000), Jones (2004), Ginsberg (2005), Depoorter and Parisi (2005), Wurmnest (2005), Brokelmann (2006) and Klee (2006).

A review of the literature reveals a number of inefficiencies in the construction of competition law as an exercise in the regulation of concentrations by a centralized administration, and thus helps explain contemporary calls for mixed enforcement regimes. First, in the presence of diffuse and costly information, public agents have a limited capacity to identify anticompetitive agreements and abusive practices. Private enforcement deals with this problem with the promise of a bounty for agents with specific...
knowledge about explicit or tacit arrangements. Second, the literature suggests that even when the right information is available to public servants, they may not have the right incentives to implement the legal rules in an efficient manner. Specifically, public enforcement of antitrust laws may lead to over-deterrence of potentially beneficial business arrangements (Williamson, 1983), and under-deterrence of more costly practices, as in Becker and Stigler (1974) and Friedman (1984).

Even without regulatory capture, economizing practices by public enforcers reveal the presence of incentives to divert resources to actions against firms less likely to be able to defend themselves. First-generation models suggest that private enforcers improve the available information set to the legal system, and help direct investments in enforcement activity to harmful acts that public agents may choose to ignore. Second-generation models further point out that a mixed enforcement regime can increase the transaction costs of capture relative to a purely public or private arrangement for the identification of offenders and their prosecution.

5.2 Sexual assault and domestic abuse

Sexual assault against women is a common crime perpetrated by men who are often acquainted with their victims before the fact. Many assaults go under-reported, and consequently under-punished and under-deterred in public legal systems. Since public prosecutors in modern societies tend to be male, female victims may be less inclined to report offences if they suspect that the police or prosecutors will be biased in their interpretation of the facts. Moreover, victims are also likely to internalize the high burden of proof required by criminal courts to convict assailants. Police departments try to deal with this problem through a number of measures, including hiring more female officers, or by setting up special victim’s units with qualified personnel. In this context, improving enforcement entails opening the communication channels between victims and public enforcers of criminal law.

However, studies by Becker and Stigler (1974) and Garoupa and Klerman (2002) point out that administrative improvement will not be sufficient in dealing with all classes of offences. Assaults likely to be ignored under a public system include those committed by the public enforcers themselves, or those committed by judgment-proof offenders with access to enough resources to immunize themselves against public prosecution either by paying bribes directly, or by buying the services of resourceful lawyers. When communication channels between victims and enforcers are not adequately open, the resulting under-enforcement of the law generates incentives for victims to seek out private remedies. Rationing by public enforcers hence justifies the purchase of instruments like pepper
sprays and guns. Private civil actions are an alternative to these instruments of violence that appear necessary when state institutions do not adequately constrain the tendencies of offenders. Allen (1996) argues for the use of civil liability in the case of sexual offences arising in the course of professional relationships. However, civil rights of action against judgment-proof offenders without adequate resources to compensate their victims are unlikely to generate adequate deterrence by themselves. Optimal enforcement hence requires the overlapping jurisdiction of effective criminal and civil prohibitions.

The issue of domestic abuse can be analyzed within a similar framework. As in the case of sexual assault, asymmetries in the physical capacity of men and women, as well as plausibly a wide range of other economic and psychological factors, allow such abusive practices to go under-reported and under-detected (Type II errors or false negatives). In contrast to sexual assault where some proportion of offenders are not known to their victims, domestic abuse takes place in situations with significant investments in relationship-specific capital, for instance in children. These investments generate incentives for the victims not to reveal information about their ordeals, sometimes even to their own family members. If public divorce rules do not associate the ex post distribution of jointly owned assets, including children, with evidence of previous abuse, then the victims face a serious dilemma about revealing such information. With or without divorce, exposing the secret can impose emotional and financial costs on the entire family. For instance, if the offender is found criminally liable, and hence subject to the imprisonment and/or labour market restrictions associated with such a label, it will most likely translate into lower family income. The hesitation of victims to provide information to the police or public prosecutors in these cases clearly illustrates the limitations of public enforcement in this area. To encourage victims to report abuse, it may be necessary to link the distribution of marital property, or future earnings of the abuser, to the presence of domestic abuse in divorce proceedings. In jurisdictions where prenuptial agreements are common, rules that invalidate such private contracts in case of abuse could be codified in their terms, or be incorporated by family court judges and private arbitrators in divorce proceedings.

It should be also noted that given the private nature of the abuse and the resulting high degree of informational asymmetry between the family and outsiders, the potential for false positives increases in a system that provides monetary incentives to allege abuse. Consequently, the delineation of evidentiary standards will play an important role in minimizing false positives.
5.3 Martial law
Most jurisdictions keep sets of emergency measures on hand for application in situations when the normal legal enforcement mechanisms are no longer effective. By declaring martial law, local rulers or foreign invaders indicate that the standards of punishment have changed from ones that emphasize investigation and negotiation through the courts, bureaucracy, or legislative bodies, to those imposed in a discretionary manner by the military or the police. Shifting to heavy and randomized punishments under martial law may be desirable to counter instability. However, as suggested by Persson and Siven (2007), a switch towards ‘hang them all’ strategies also increases the probability of false positives as soldiers and the police are encouraged to engage in the collective punishment of a population, or publicly torture political opponents to induce compliance with their will. As martial law persists, false positives motivate investment by victims to defend themselves against persecution by the authorities and the costs of collateral damage in terms of life and property.

One way of dealing with this problem is to set up instruments of public law – such as those which now apply to Bosnian war crimes – to motivate political and military leaders not to engage in collective and randomized punishments. A second option would be to execute the alleged perpetrators – as was the case for Benito Mussolini or Nicolae Ceausescu. Mongerald (2006) suggests the imposition of corporate civil liability enforceable by victims of illegal destruction of life and property as a complementary method for checking the practices of professional and mercenary armies that are deployed around the world.

5.4 Environmental pollution
Hirart et al. (2004) describe private enforcement as an instrument for the verification of environmental standards set by a regulatory authority. Their analysis suggests that optimal *ex ante* regulation fails to be effective in the absence of courts that are able to generate information about adherence to standards of care by industry necessary to avoid large-scale damage. Private enforcement thus complements the efforts of state inspectors and regulators constrained by their budgets and information. Price (1985) looks at the interaction between public and private enforcers during the implementation of clean water regulations in the United States, after the adoption of Federal environmental statues during the late 1970s. The rise in cases brought to court by private citizens under the Clean Water Act forced public enforcers to ‘grapple with the question of whether to view private enforcers as compatriots or competitors’ (Price, 1985, p. 31). Federal administrators appear to have viewed private enforcers as compatriots, at least immediately following the adoption of legislations.
Interestingly in this case, private enforcers appeared to exhibit a strong interest in complementing public regulatory activities, despite the fact that these litigants could not expect any pecuniary reward. This was because all fines paid by violators in the private action cases were allocated to the public treasury instead of to the litigants – as would happen in private tort, property, or antitrust claims. In the case of clean water regulations, just the legal right to file a grievance through the courts appears to have been sufficient to generate a mixed enforcement regime where private persons and organizations with information about violations specialized in enforcing the standards, and the public administrators in setting them.

5.5 Corporate Finance

Hay and Shleifer (1998) explore the possibility of using private rights of action in securities markets. They argue that because public securities regulators interact more frequently with firm managers, efficient enforcement of information disclosure rules often requires private legal actions by subgroups of outside investors. In the absence of private access rights, the pattern of interactions between regulators and managers lowers the incentives of prudent investors to extend financing, and limits the prospects for the development of informationally efficient capital markets. Djankov et al. (2008) construct empirical indicators of public and private enforcement procedures for 72 industrialized and developing jurisdictions. Their analysis reveals that the ability of governments to impose fines or prison sentences is not correlated with the growth of securities markets and does not appear to limit the capacity of insiders to ‘tunnel’ or ‘self-deal’ company cash flows for their private benefit. In contrast, the growth of financial markets and access of firms to external finance benefit from the presence of an easy burden of establishing standing by external investors in courts. The optimal approach to structuring corporate regulations involves the complementary use of (a) public enforcers who set standards for disclosure of information about managerial practices, and (b) access rights by private enforcers with the best information and incentives to identify and punish offenders of legal rules.

References

Private enforcement of law


