

Original article

## **Irrationality in Politics and Governance of Maritime Affairs: The Collapse of Sovereign Maritime Governance\***

*Okan DURU*

Dept. of Ship and Marine Tech., Izmir Katip Celebi U., Izmir, Turkey  
& International Maritime Research Centre, Kobe University, Kobe, Japan, [durokan@yahoo.com](mailto:durokan@yahoo.com)

### **Abstract**

This paper investigates maritime policies from the perspective of behavioural law and economics by questioning the role of political instruments, levels of development, groupthink bias, moral hazards and practical examples. Through the emergence of deregulation and procedural simplification, the reasons behind overregulation need to be revisited. The future of maritime governance is expected to hollow out several functions for alternative institutions and keep the governance simple for performing other roles such as advisory services, mainstreaming, amongst others. Therefore, the concept of maritime governance without a government can be thought as a driving force for the future. Based on the deregulation and the hollow-out framework, maritime governance (particularly in developing and developed countries) should focus on the softpower of maritime administration and the role of expert power; as well as referent power to mainstream the maritime industry.

*Keywords:* Maritime policy, maritime governance, behavioural law, groupthink bias, moral hazard.

## **I. Introduction**

Theoretical and empirical economics have undergone a complete transformation since the times of orthodoxy economics. Through the mathematical complexities and benefit of reductionism, traditional economics is expected to uncover economic phenomena, while proposing useful tools for policy makers. The gap between academic expectations and their practical outcomes has drawn particular attention to the limitations of existing economic doctrine, as well as human behaviour. The emergence of Behavioural Law and Economics is therefore a natural result of these failures which is in contrast to the success of intellectual prosperity in the last few decades. Policies and governance practices are some of the topics visited here, and maritime policy is highlighted as an example.

Roe (2013) emphasised the policy failures in the maritime industry and investigated a number of practical examples of this in our time. For example, the European Register of Shipping project of the EU could not be put into practice since the rational actors (i.e. shipowners) focused on cost minimisation, procedural convenience etc. rather than holism and the derived prestige of the flag state. Real prestige is gained through maintaining a positive business reputation in today's shipping world. Shipping is broadly an offshore business with regards to globalism and free trade. The study of Roe (2013) implicitly mentioned having to face aspects fallibility and the complexities that come with it alongside the fact that human is not computer. The age of supreme policy institutions with command and control almost came to an end, and the new era is about encouragement, *governance without government and policy instruments which work with human nature and its irrationalities*.

On the other hand, the diversity among the stages of development should be kept in mind when analysing the maritime policies. It is obvious that countries at different stages of socio-economic development may have different circumstances and instruments. An undeveloped country needs to subsidise some industries since the capital accumulation is not enough for costly investments e.g. marine ports. However, developed countries usually do not employ subsidies. Therefore, for the academic interests of scholars who are interested in developed countries problems this may not be useful. However, the work paves the way for discussing the challenges of the developing stages.

This paper investigates the objectives of maritime policies and their functions as well as deteriorating factors and practices. Finally, the concept of government without governance is discussed as an alternative model of maritime governance.

## **II. Objectives and Instruments of Maritime Policy: The Visible Hands**

According to Selkou and Roe (2004), there are seven major reasons for maritime policy (a recapitulation from the original document):

- *Dealing with the competition (Monopoly or excessive competition)*
- *Government intervention and fiscal support (high cost infrastructure, subsidies, public goods, privatisation etc.)*
- *Externalities (environmental debates)*
- *Development (economic impact of the industry)*
- *Labour force (labour rights, education)*
- *Defence (maritime piracy)*
- *Prestige (holism, flag waiver)*

In addition to Selkou and Roe (2004), World citizenship (representativeness for global debates e.g. UN legislations) can also be an additional reason for having and developing maritime policies. The level of development also defines the priority (i.e. demand) of each aim of the maritime policy. The policy instruments for performing these objectives include, but are not limited to:

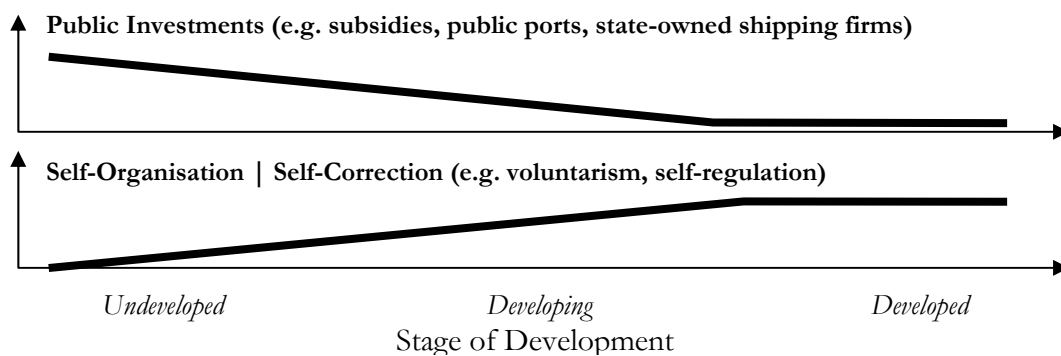
- *Legislation (Codes, standards, maritime law)*
- *Funding (e.g. subsidies, grants, low interest loans)*
- *Sponsorship/Guarantorship (e.g. loan guarantees)*
- *Taxation and charge systems*
- *Legal permits or prohibitions*
- *Public direct investments (public ownership) or Privatisation of existing investments*
- *Certification and Qualification (e.g. licences, authorisation, permits)*
- *Mainstreaming , Advertising and Campaigns*
- *Monitoring, Research and Consultation (liberitarian paternalism, maritime intelligence, priority setting, consensus building)*
- *Navy Force (e.g. against piracy attacks)*

As a mission of maritime governance, the state of shipping competition is expected to be monitored for eliminating both monopolies and excessive (deteriorating) competition. The monopoly debate (or oligopoly for some countries) is somewhat related to government interventions like subsidies. In the developing stages, many countries support particular business groups based on their lack of entrepreneurs and the high cost of critical services and infrastructures. These business groups are supported financially or politically through lending, subsidy or legal permit instruments. The role of ‘crony capitalism’ should also be pointed out since it has the potential to make an impact in the development progress. Over the last few centuries, there are several examples of public-private relationships which generated large pyramidal business groups such as East India Company of British Empire, Zaibatsu of Japan and Standard Oil Company of US. In *The Visible Hand* (1977), Alfred D. Chandler highlighted the large business groups and criticised the invisible hand metaphor of Adam Smith (1776) by proposing the use of the visible hands of vertically integrated corporations. Chandler (1977, 1990) correlates the organisational transition with economic development. The organisational transition

reduces the number of large family controlled business groups while waxing the professionally managed firms. Four major economies (US, UK, Japan and Germany) are noted for this. . In addition to the major economies, there are currently economies en route to the transition as well as economies adopting the same principles like Chaebol of South Korea and China who are gaining inspiration from it. (Economist, 1997). Looking from a wider perspective, the constitution of large business groups backing public sponsorship seems essential for developing nations while the monopolies and family-based organisations should be eliminated or forced into organisational transition after an initial industrialisation stage. Therefore, for action to take place, a monopoly/oligopoly of large business groups is needed to establish an origin point of industrial development.

In the maritime industry, the East India Company is one of the oldest examples of the completing the transition. Rather than undergoing transformation, the company encountered collapse. In case of Japanese shipping industry, the transition is performed by Zaibatsu to Keiretsu (Japanese network economy), but the Japanese shipping giants retained their leading position in both the national and international arena. NYK of Mitsubishi Group, MOL of Mitsui Group and K-Line of Kawasaki Group are flagships of their network of companies such as banks, heavy industries, electronic firms etc.

Government intervention is negatively correlated with the stage of development. Undeveloped countries and developing countries strongly need the public-private partnerships, subsidies, public investments (especially marine ports) and paternalism (for libertarian paternalism, Thaler and Sunstein, 2003). As development progresses, governments transfer their physical instruments (maritime hardpower) to industrial institutions for establishing a self-regulative regime (Fig. 1).



**Figure 1: Development vs. Government Intervention and Self-organisation**

Source: Author's illustration.

The recognition of staging in maritime governance and policy making is a change-making tool for both smooth transition and improving shipping prosperity. On the other hand, political actors should be aware of how this transition is managed with the irrationality of human behaviour. With regard to political decisions and governance framework, the structure of decision making

mechanisms and the role of group decisions needs to be revisited in terms of their failures and the lack of individual liability.

### **III. Groupthink Bias, Political Ventures and Illusion of Control**

Through the rise of critical debates on traditional economic doctrines including the rationality assumption and the efficient market postulate, behavioural law and economics has emerged to justify existing theories working with the irrationality of decision makers as well as political actors. The rational voter assumption is criticised in the literature, and the potential impact of bad policies under the democratic election system are already indicated for larger societies such as at political elections or with regard to policy selection at international institutions (e.g. Caplan, 2011). Based on the theory of wisdom of crowds, broader participation is expected to conclude a more accurate outcome (Surowiecki, 2005). However, when voters/decision makers are irrational, even a democratic selection may find failings in what are proposed to be solutions. Similar dynamics can be found in smaller societies such as board meetings, national policy making forums etc.

In addition to the rationality problem, collective decision making systems may reveal a dysfunctional outcome (irrational conclusion) which is called groupthink bias (Henningesen et al, 2006). Some examples of groupthink bias can be found in policies developed by International Maritime Organisation or the EU. At the development stage (when critical problems remain unsolved), international and supra-national (e.g. EU) organisations are very purposeful and efficient. The safety legislation (e.g. SOLAS) has filled the emergent gap, and it is still the leading regulation in the maritime industry. On the other hand, these organisations may fail to develop useful and practical solutions for secondary debates. For example, the practical efficiency of the safety management system (i.e. ISM Code) and ship and port security regulations (i.e. ISPS) are still criticised by both officials and shipping companies. The practicality of processing a large amounts of paperwork broadly depends on the technological quality of ships. Ships advanced in technology may save time for officers with regard to paperwork duties. Another example of this is the *Motorways of the Sea project* of the EU<sup>1</sup>. Although particular effort and time was spent for the project, it could not be put into practice for the most part. The fundamental rules of free market were ignored for the project, and it is thought to be practical to organise several private and public institutions. Baidur and Viegas (2011) conclude that:

*“...in spite of strong political backing and favourable policy initiatives, MoS- Motorways of the Sea projects have met with limited success. Establishing MoS is complex because of its international scope and involvement of a number of public and private stakeholders with conflicting objectives and goals”*

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<sup>1</sup> European Commission, 2001. White paper. European transport policy for 2010: time to decide. Commission of the European communities. COM (2001) 370 final, Commissions of the European Union, Luxembourg.

There are many other examples of policy failures which Roe (2013) also discusses the common driver of these political inconsistencies is the groupthink bias and its components. The illusion of invulnerability which creates irrational optimism and overconfidence is one of the symptoms of the groupthink bias. In the group thinking environment, decision makers tend to take extreme risks or ignore possible dangers. Collective rationalisation, ignoring the ethical and moral consequences of their decisions and self-censorship are some of the other drivers of the failure. Groupthink bias can generate political ventures (e.g. MoS) which are risky in terms of their practicality, budget constraints, need for large acceptance (i.e. mainstreaming), amongst others.

However, there are more fundamental reasons for the groupthink bias. In behavioural law and economics, the *winner's tragedy* is frequently discussed through the collapse of large companies and formerly successful organisations. An institution or an individual may obtain repetitive victories and have a strong reputation based on skills or luck or a mix of both of them. Such a successful background sometimes results in overconfidence and taking extreme risks. There is a strong connection between the stages of development and the winner's tragedy. An undeveloped country (imagine the world of a century ago) has several fundamental legislations, and there is strong potential for practical policies. However, since the society is smaller and simpler, public institutions have the power to practically apply them. By establishing several successful regulations with efficient practical applications, policy makers lose their critical judgment and self-control.

At the early stages of development, governments and international organisations have control of the initial legal framework. The problem is that the temporary control of these initial stages deteriorates as the societies get larger and the resulting out of control debates. Based on the previous regulative performance, the role of the policy maker and their policies are exaggerated which in turn causes overregulation and impracticality. Most developed countries recently dealt with the simplification and reduction of the legislative framework as well as empowering alternative organisations instead of relying on public intervention (e.g. Agencification). The term, control delusion (i.e. illusion of control), is used for indicating the phenomenon in which individuals or groups overestimate their power with regard to processes and systems.

#### **IV. Perspectives on Maritime Policy Instruments and the Moral Hazard**

In the history of mankind, many different kinds of instruments are used for controlling, regulating and managing the maritime industry. The *British Navigation Act* (1651) is one of the oldest maritime legislations which regulated most shipping businesses until 1849 (practically 1810s) under the influence of a *laissez-faire* philosophy. The British Navigation Act was a primary reason for the poverty and starvation in Europe, and, in turn, it was also one of the drivers of *French Revolution* (1789) and the *Napoleonic Wars* (1803–1815). Therefore, some historians indicate that “*all history is maritime history*” (e.g. Lincoln Paine, author of *The Sea and*

*Civilization: A Maritime History of the World*), hence maritime policies and government actions may have great impact on both global politics and economics.

On the other hand, the inconsistency and impracticality of several maritime policies draw particular attention as to whether some lessons could be from these experiences. The proper investigation and criticism of failures can lead to creating positive change. Although the entire focus is given to lessons learnt, it is usually assumed that all lessons are recognised. People are also expected to focus on what was ignored.

Through the emergence of behavioural law and economics, several assumptions behind the decision, policies and behaviours are rethought to find out the primers of omissions and the cognitive blindness to some kinds of problems. Among these assumptions is that the rationality postulate is the most popular debate, and its impact on maritime policies is unavoidable. For example, legislations for eliminating marine accidents can only reduce accidents not the drama in the sense of Tiberg (2005).

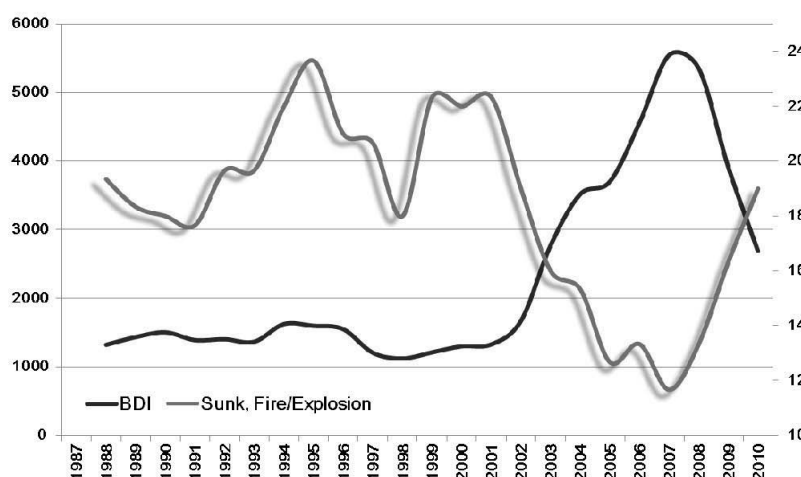
Tiberg (2005) indicated the moral hazard on marine accidents as follows:

*“Fraud is rampant in Maritime Law and Insurance. There are a number of reasons for that. Ships and cargoes are comparatively easily disposed of either into the anonymity of the international theatre or by being scuttled into the unfathomable vastness of the ocean depths.”*

According to the recent statistics of dry bulk freight rates (Baltic Dry Index-BDI) and marine accidents (excluding ship-to-ship accidents and accidents in the vicinity of ports and channels), there may be a strong association between marine accidents and the state of the market (Fig. 2). Up until 2007, most of the political actors in the maritime industry were confident about the functionality and usefulness of the regulations. However, the downturn of the freight markets has highlighted the winner’s tragedy in marine accidents. With the improvements of repetitive years, political actors strongly credited the regulatory system as the driver of the decline. The rise in marine accidents since 2007 completely changes the interpretation, while looking at marine accident statistics in their entirety shades the dynamics behind the data (About the statistical profession or ignorance, please refer to Huff (2010) or Best (2004)). In cognitive science, the false cause fallacy (i.e. *Post hoc ergo propter hoc*) is used for figuring out such illusory correlations between events.

There is an implicit assumption of morality amongst other fundamental principles that is taken for granted. Legislations are usually developed by assuming individuals or institutions obey rules accordingly, while individuals or institutions assume that public representatives are ethical. Both assumptions with their bi-directional approaches may have their inconsistencies. Growing academic interest is given to moral myopia and moral muteness (moral hazard in general) in business and public organisations (Hölmstrom, 1979; Mirrlees, 1999; Menzel, 1999, among others). The major motivation behind the studies is the lack of functionality and the long term sustainability driven by conflicting incentives. In maritime governance and policy making, the interaction between shipping companies, professional institutions and public institutions should be

revisited and probably redesigned to develop incentives which improve the governance and policies while eliminating overregulation, commission incentives and moral muteness. Overregulation is one of the most popular topics in political science, and many governments have recently been working to reduce and simplify the existing regulations, as well as to transfer some instruments to professional agents. This approach is very much a key point in the “*Governance without Government*” perspective.



**Figure 2: Baltic Dry Index (annual average, left scale) and total losses (no. of ships over 3,000 dwt, sunk, fire/explosion) with 3-year moving average (dry bulk carriers and general cargo ships).**

Source: World Casualty Statistics, Lloyd’s Register (several issues), Baltic Exchange.

*Commission and/or monopoly-oligopoly incentives* can be found in explicit or implicit forms. For example, ISPS Code legislation has been easily welcomed by shipping consultants and management advisors (also security firms) (demand for a new business) at the expense of service fees. People in the maritime industry know well that ISM Code is an obligation which has already been established in leading carriers many years ago. For this reason, ISM Code (similar to many others) implicitly created an instrument to level up leading carriers and differentiate shipping companies which unfortunately has led to generating trading inequalities (trading area, tonnage and route limitation). Without the arrival of the Port State Control (PSC) mechanism, the ISM Code would not be able to produce a practical improvement. Therefore, the PSC mechanism is probably one of the most innovative and functional products in the international maritime society. The critical question however is whether PSCs can produce same outcome without an ISM Code framework. PSCs usually investigate the competency of ships based on fundamental legislations such as SOLAS, MARPOL, among others. For many, ISM Code is more of a paperwork procedure which results in a lot of paper consumption, ticking boxes and doing nothing than more than usual. Perfunctory demonstrations do not improve a process, but it may implicitly contribute to a kind of oligopoly by creating a new obligatory instrument to eliminate some competitors. The phase-out legislation for single hull tankers did not end the risk of oil spill (May, 2013), but it definitely created a new business for ship recycling or conversion industry.



Finally, the role of *moral muteness* (or moral hazard) should be discussed in terms of policies and creating new business through the public policy mask. Over intellectualising the legislative proposals can attract obedience to authority as a result of moral muteness. The role of moral hazard and unobserved behaviours are growing topics in the literature of finance and economics (Hölmstrom, 1979; Mirrlees, 1999). In political science, moral hazard is one of the reasons behind government failure (Le Grand, 1991). The political mechanism of the international maritime legislation and the philosophy of maritime governance somewhat reinforces the moral muteness.

Before discussing the problem, it would be useful to investigate the assumptions that drive political actors and diplomats. The assumption that the lawbreaker and criminal shipowner is one of the drivers of maritime diplomacy and political philosophy. Therefore, maritime policy makers think they are superior to act with the paternalist perspective against shipowners. At the same time, some leading shipping companies are thought to be references for developing frontrunner legislations. There are some 'good boys' as referenced, and there are 'bad boys' for being controlled and monitored. The existing mind-set and diplomatic orthodoxy implicitly set a higher standard based on the reference rather than the mean. The practicality, usefulness and sufficiency at the referenced firms are imported to the global coverage with legislative instruments. Consequently, a gap between legislation (objective) and the business practice exists. The level of expectations should match the practical capacity. Therefore, the rational perspective integrates theory and practice with feasibility and fair circumstances.

The moral muteness can be found as the blindness to impracticality and social justice when maritime legislations are developed. As a result of the moral muteness, overregulation and extreme authorisation for central governments or international institutions are debated as an irrational product of '*regulation addiction*' (i.e. control addiction).

## **V. Maritime Governance without Government: Instrumentation and the Hollowing Out of the State**

Through the emergence of non-governmental resolutions, new forms of governance and policy making have been developed to deal with the problems of this century. Post-modern enlightenment has contributed to the criticism of the conventional perspectives on maritime governance and legislation. In the 21<sup>st</sup> century, maritime public governance is expected to promote non-governmental participation on regulatory processes (e.g. self-regulation, quasi-regulation, co-regulation) as well as acting on behalf of public institutions (e.g. voluntarism, empowerment, agencification). The '*Governance without Government*' perspective has spread out influencing trends of deregulation and simplification.

The global shift on public governance and political perspective has a number of dimensions in terms of maritime affairs. Maritime governance without government does not mean to eliminate entire regulatory instruments, but it means shifting from hardpower politics to softpower politics. In political science, the hardpower is usually thought of as a military power. However, it is not

limited to military power and actually covers a wide range of instruments including economic or legislative ones. For the politics and governance of maritime affairs, hardpower may refer to ports, flag state instruments, taxation, authorisation-certification, auditing-inspections, amongst others. French and Raven (2002) classify the sources of power, and legitimate (legal) and coercive powers are some examples of bases for hardpower. However, these kinds of power can easily be lost if the leadership role of public institutions is not recognised by stakeholders in the maritime industry.

Maritime softpower is an indirect form of governance through the construction of preferences, mainstreaming and supervisory functions accepted and trusted by stakeholders. The expert power and informational power play a significant role in the building of a maritime softpower (French and Raven, 2002). The essential objective is to serve as a reference for influencing the improvement of individuals and institutions t.

Rather than a direct regulatory role, other forms of regulatory functions are utilised on behalf of government intervention. For example, self-regulation or quasi-regulation methods can be used as alternatives. Voluntarism is a form of self-regulation. In the maritime industry, voluntarism is already employed for some purposes (e.g. professional associations for certification) in many countries. The conventional classification societies serve on behalf of governments which is a form of voluntarism. On the other hand, the promotion of the maritime industry and attracting investors need different kind of institutions. For the Motorways of the Sea project, EU members established several promotion centres for transferring land transport to maritime transport while the project did not succeed in public-private collaboration, education, labelling, rewarding may be employed alternatively.

Different forms of non-government solutions can be developed from existing experiences. Incentives, behavioural law and empathy are some important drivers of the outcome of such solutions. Private institutions do not move voluntarily without economic incentives. Political actors need to focus more on how to push and motivate people in the maritime industry.

## **VI. Conclusions**

Assumptions are frequently used in scientific research for simplifying problems and making models executable with the existing tools. However, some of these assumptions may drive people into ignorance and hasty generalisations. In economic and political science, the rationality postulate is taken for granted in the long history of academic interest, while few scholars tend to criticise its drawbacks. Through the emergence of behavioural law and economics, both scholars and political actors refresh their existing knowledge and perspectives.

In the politics and governance of maritime affairs, a similar re-examination is needed to overcome problems based on regulatory tradition (e.g. over-regulation, regulation addiction) while redesigning the maritime legislation framework. This paper extends the debate given by Roe (2013) as '*maritime governance failure*' with a particular focus on the behavioural aspects of

maritime legislation and political actions. There is a clear switch in the instruments used and philosophy of maritime policy making. Developed countries encounter several problems of modern community and governance styles while developing nations benefit from those past experiences. Legislative simplicity, functionality and non-government governance are post-modern objectives of maritime politics. The 'Governance without government' concept spreads around the maritime nations while it is still a question as to how the structural and legal shift from the traditional framework to the hollow state can be performed smoothly and voluntarily.

For a seamless shift, instruments such as self-regulation and voluntarism are suggested in addition to the mental readiness of the governments. Based on the adverse effects of fundamental legislation, governments and international institutions tend to overvalue regulatory power by ignoring the practicality and legislative maturity. Therefore, political actors need to recognise limits of regulatory power and the potential of referent power as a prerequisite of mental readiness. Rather than insisting on additional legislation, a particular focus should be put on the instruments of post-modern maritime politics and governance.

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