

Self-Governance, Property Rights, and Illicit Commerce*

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Abstract

The legal centrism hypothesis argues that the state is necessary to define and enforce property rights, and in the absence of state-based institutions, self-governing groups will be incapable of engaging in economic exchange and extended commercial enterprise. This paper provides evidence against legal centrism by examining the operation of the Nuestra Familia prison gang. The gang protects inmates' property rights and facilitates trade in contraband in California prisons, and they operate an illicit business enterprise in the free world from behind prison walls. An important reason for the success of their organization is a system of information transmission mechanisms between gang members in different facilities. These mechanisms allow self-governance among people with high discount rates and criminal histories.

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1. Introduction

Governance institutions provide rules of the game that facilitate human interactions, and they vary in their form and effectiveness. When governance institutions work well, people engage in economic exchange. When these institutions operate poorly, markets fail and costly disputes over property rights occur. Legal centrism argues that the government “is the exclusive creator of property rights” (Ellickson 1989) and “that rational law cannot arise spontaneously from human interaction, but instead requires deliberation and debate...and that laws must be made deliberately to be rational” (Cooter 1993: 417, 427). Government, therefore, must provide governance.

This paper challenges the legal centrism hypothesis by examining the internal governance institutions of prison gangs, arguing that order and property rights can emerge without the state. The *Nuestra Familia* prison gang in California operates without reliance on contract law or government protection of property rights, yet the group develops effective self-enforcing internal governance mechanisms to limit opportunistic and shirking behavior. Despite its status as an outlaw group, it successfully operates large-scale criminal enterprise.

2. Literature Review

Groups of individuals need rules to govern interactions among themselves and with other groups. Government can provide these rules through the legal system, but under many conditions, privately produced, self-enforced governance institutions can operate effectively. As a positive research question in political economy, “analytical anarchism” focuses on identifying the institutional mechanisms that facilitate self-governance in different contexts (Boettke 2005).

An extensive literature on the historical operation of private law and self-governance finds that order without law is often both possible and profitable (Stringham 2015).

This literature focuses on two environments of self-governance. Intragroup governance coordinates joint activity to achieve commonly desired ends within a defined group of self-identified members. Intergroup governance, on the other hand, facilitates cooperative interactions between people of different groups. The ability for governance mechanisms in either environment to arise outside of a centralized and consciously designed government institution depends, in part, on the demographics of the community's population. The more trustworthy people are and the lower their discount rates, the easier it will be to deter defection and punish it when it occurs. The more hostile, non-cooperative, and impatient people are, the less likely it will be that self-enforcing governance mechanisms will generate beneficial outcomes.

Institutions are not robust if they can only come into existence when people act ideally or in ideal situations (Pennington 2011). Past work provides evidence about how robust self-governance mechanisms can be to various environmental and population characteristics. Consider the matrix below (Figure 1). The rows distinguish between intragroup governance and intergroup governance in peaceful and hostile contexts. The columns identify whether the state suppresses the self-governing community.

Figure 1: Examples of Self Governance Under Different Conditions

		Government Suppression	
		<u>Absent</u>	<u>Present</u>
Type of Group Governance	Intragroup	I Orthodox Jews	II Pirates
	Intergroup (Peaceful)	III Maghreb Traders	IV Medieval Temples
	Intergroup (Hostile)	V Anglo-Scottish Borderland	VI Nuestra Familia

The most well researched context of self-governance focuses on self-enforcing commercial exchange (category III in Figure 1). Intergroup governance of commercial traders (a peaceful context) allows widespread and long-distance trading to flourish in the absence of government with the aid of a diversity of commitment mechanisms and signaling strategies (e.g. Benson 1989; Clay 1997; Schaeffer 2008). Avner Greif's work (1989) on the Maghribi Traders is a well-known example. Empirical work on cults, communes, and other collective groups (Iannaccone 1992), such as Orthodox Jews (Berman 2000) and charitable organizations (Skarbek, forthcoming), shows that intragroup governance can limit free riding and facilitate internal governance when government suppression is absent (category I).

Self-governance is less likely to be effective when the participants are biased to be uncooperative, have high discount rates, or are actively suppressed by the government. However, recent research documents the mechanisms operating in particular places and times to show how self-governing communities overcome these problems. Intragroup governance in the presence of government suppression (category II) was possible for 18th century pirates who developed a self-enforcing constitution to prevent internal predation by a ship's captain (Leeson 2007). Medieval

temples and monasteries provided Japanese landowners an alternative to the government for conflict adjudication in commercial disputes and protection from external threats (Adolphson and Ramseyer 2009), showing that intergroup governance mechanisms can effectively protect people engaged in peaceful exchange from predatory states (category IV). Groups that are free of both government suppression and governance can still create rules to govern interactions (category V). For example, hostile groups along the Anglo-Scottish borderland in the sixteenth century developed rules that limited violence (Leeson 2009). The diversity of historical examples suggests that self-governing mechanisms that establish property rights can be quite robust.

The current chapter examines the remaining category: instances in which groups that are hostile to each other are interacting in the face of government suppression (category VI). The Nuestra Familia prison gang protects property rights and mediates conflict between rival street gangs in the face of active government suppression. They are willing and able to do so because their ability to tax drug dealers transforms it into a stationary bandit (Skarbek 2011; 2014).

Compared with the literature on self-enforcing commercial exchange, there is relatively little research on intragroup governance mechanisms in the presence of government suppression. Just as businesses in traditional markets devise mechanisms for overcoming organizational costs arising from transaction costs (Milgrom and Roberts 1992; Miller 1993), the mechanisms developed in illicit groups depend on the context. For example, one drug-dealing street gang overcame significant monitoring problems with careful accounting, and they motivated employees with the potential for promotion into high paying positions (Levitt and Venkatesh 2000). The following sections contribute to this literature by examining the incarceration context, where communicating information about peoples' actions and reputations is especially costly. Given these costs, establishing information transmission mechanisms is crucial to success. The

Nuestra Familia prison gang defines and enforces property rights in prison, facilitates illicit trade, and directs criminal regiments outside of prison from behind bars.

3. The Nuestra Familia Prison Gang

3.1 Brief Overview

Since the 1960s, the Nuestra Familia (NF) prison gang has played a prominent role in the criminal underworld in Northern California. They are the second largest prison gang in the California corrections system, and in addition to being a major source of drug trafficking behind bars, they engage in robbery, extortion, and murder for hire. They recruit members primarily in prison. Members swear lifetime allegiance to the gang, and when released from prison, gang members are required to continue working for the gang in specific geographic regions (Federal Bureau of Investigation 2009: 13). NF has become a highly profitable criminal enterprise with several hundred members and thousands of associates who facilitate their operations. A former Federal prosecutor describes the NF as being as sophisticated as a Fortune 500 company (60 Minutes 2005, see also Lewis 1980; Koehler 2000; United States v Rubalcaba et al 2001; Fuentes 2006; Skarbek 2010; 2012).

The California Department of Corrections and Rehabilitation actively disrupts NF operations. When gang members are identified, they are held in restrictive cellblocks, and the highest-ranking members usually reside in super-max facilities or a secure housing unit where they are locked in their cells for up to twenty-three hours a day. Law enforcement organizations regularly investigate NF members outside of prison and prosecute them for narcotics trafficking, home invasion robberies, and murder. Because they are engaged in illegal activities, intragroup

governance cannot rely on courts of law to protect their property rights, and employment law cannot govern the relationship between gang leaders and members.

In 1967, the NF formed and outlined their original internal governance system in a written constitution (Fuentes 2006, 3-11; Skarbek 2010; 2014). Since then the constitutional rules have changed in several ways. Some of the positions have been altered or renamed and various subsidiary groups have been created and terminated to aid NF. Robert Gratton, a member of the gang who became an informant for the Federal Bureau of Investigation, provided written correspondences between gang members, including orders from incarcerated leaders (Fuentes 2006; also see United States v Rubalcaba et al 2001, 4). These messages contain information about how the gang implemented the organizational structure outlined in their written constitution. These internal communications and the gang's constitution explain how NF uses information transmission mechanisms to provide protection of property rights behind bars and allows incarcerated gang leaders – who face high information costs – to monitor and direct gang activity in the free world.

3.2. NF Protects Property Rights and Facilitates Exchange

Legal centrism argues that only the state can define and enforce property rights, but this does not imply that the state always can and will do so (Stringham 2015). Correctional officers frequently are incapable of obtaining the information needed to punish or deter inmate-on-inmate harm. First, correctional officers often do not believe inmate claims of victimization. Inmates file false complaints for numerous reasons, including getting time away from prison jobs, moving to different cellblocks, avoiding other inmates to whom debts are owed, and as a means of entertainment. Second, even when correctional officials believe an inmate has been victimized,

the anti-snitching culture that exists in prison often prevents collection of evidence and witness statements. When correctional officials do obtain evidence, they must convince the local district attorney to file charges. A former San Quentin Prison official estimates that, over the course of a year and a half, the local district attorney pursued three out of one hundred cases that they submitted (Porter 1982, 16).

It is also important to ask how reliable state enforced property rights will be. Correctional officers are not perfectly monitored by their superiors, and they may lack the motivation needed to investigate a complaint or punish the victimizer. One sociologist describes correctional officers as passive victimizers, noting that in contemporary prisons, they have “withdrawn to the walls, leaving inmates to intimidate, rape, maim, and kill each other with alarming frequency” (Irwin 1980, vii). To the extent that guards actively influence the inmate social system, they may exhibit bias. In the 1960s and 1970s, penologists argued that many guards held prejudiced racial views and gave preferential treatment to white inmates (Irwin 1980, 124-129). Although not representative, news accounts regularly report on correctional officers who neglect their duties, smuggle contraband into the facility, and victimize inmates (for example Piller 2010). In the 1990s in California’s Corcoran Prison, numerous correctional officers were reportedly “staging [involuntary] inmate fights, sometimes wagering on the outcome and then, when those fights got out of control, of shooting the inmates involved...[and correctional officers also] allowed inmates to be raped by other inmates, as retaliation against those who had gotten out of line” (60 Minutes 1999; also Arax 1996). Although this is not the typical behavior of correctional officers, the worst outcome of state-enforced property rights appears to be the active violation of those rights and the abuse and killing of inmates.

State-based protection of property rights for inmates is incomplete or absent, and prison gangs formed to fill this need. A federal indictment explains that NF “provided protection and security for its members and associates from rival organizations and gangs both inside and outside California correctional institutions” (United States v Rubalcaba et al 2001, 2). According to prison gang members, the original founders of NF grouped together to provide protection for Hispanic inmates from rural areas in California from predatory inmates (Fuentes 2006; see also Porter 1982, 10; Camp and Camp 1985; Mendoza 2005, 22; Morales 2008, 7). Members of another prison gang, the Mexican Mafia, had frequently victimized these inmates. The abuses included theft, assault, intimidation, and murder. Inmates who were not affiliated with a gang had “to surrender their prison luxuries and items of comfort such as wrist watches, rings, shoes and anything that could either be enjoyed by [the Mexican Mafia] or sold on the prison black market” (Mendoza 2005, 22-23). These “attacks aroused and consolidated a large number of ‘independent’ Chicanos, who planned to eliminate the [Mexican] Mafia members” (Irwin 1980, 190; also Morales 2008, 20-23, 56-58). The prison gang’s earliest written constitution outlines their intentions and internal organization, explaining that the “primary purpose and goals of this O[rganization] is for the betterment of its members and the building up of this O[rganization] on the outside into a strong and self-supporting *familia*” (Fuentes 2006, 5). Former inmate and anthropologist Robert Koehler explains that NF “provides Familianos with physical protection from rival gangs and supplies them with store goods at low cost or on low credit, and Familia serves as their emotional family” (Koehler 2000, 174).

Prison gangs generally perform two related and important functions: the protection of property rights and facilitation of illicit trade (Skarbek 2014). A correctional officer with twenty-five years of experience in California writes, “most gangs in prison originally started out as

protection groups” (Morales 2008, 6). A Black Guerrilla Family prison gang member explains that joining the gang provided benefits, as they “controlled the line there by offering protection of numbers, protections of comradeship” (Porter 1982, 14). In 1985, the Department of Justice conducted a national study on prison gangs and found that their “purposes range from mutual caretaking of members to large profit-making criminal enterprises” (Camp and Camp 1985, 1). The gang maintains its power by providing “protection for its members and the exploitation of others – and through its ability to acquire and distribute goods within the prison – primarily drugs” (Camp and Camp 1985, 42).

Since they cannot use state-based institutions to deter defection and opportunism in illicit exchange, inmates rely on prison gangs to do so. Koehler explains that “the basis of Familia is capitalism...economic ventures allow Familia to counter the perceived hegemony of the guards/prison system and the threat of rival prison gangs” (2000, 170-171). NF members arrange for the importation of drugs into the prison system and they act as either wholesaler or retailer in the narcotics market behind bars. In fact, one of the primary reasons that correctional facilities try to prevent the formation and operation of prison gangs is because they are the primary source of drug trafficking (CDCR 2010, 372). A survey of prison wardens reports that drug trafficking is the second most frequent criminal activity engaged in by prison gangs and they are in charge of the majority of drug trafficking (Camp and Camp 1985, 44-45, 52-53). Gangs created a credible threat of violence to protect themselves, and once they accomplished this, they could credibly threaten people acting opportunistically during illicit trade.

The provision of protection and facilitation of exchange by organized criminal groups is actually quite common. Gambetta (1993) and Bandiera (2003) document how the early Sicilian Mafiosi protected land and enforced contracts. Organized criminal groups protect businesses and

property in Japan (Milhaupt and West 2000), post-Soviet Russia (Varese 2005), Northern Italy (Varese 2006), and around the world (Varese 2011). Recent research finds that membership in Los Angeles street gangs is a response to violence rather than preceding it. This suggests that people join gangs for protection rather than as a vehicle for engaging in violence (Sobel and Osoba 2009). Research in criminology finds that protection is a common reason given by youth for their choice to join a gang (Melde, Taylor, and Esbensen 2009), and ethnographic research finds that protection is one of the most common services that members enjoy (Jankowski 1991, 122-123).

Correctional officials failed to establish and protect property rights in prison, so inmates created their own governance mechanisms to do so. As a former inmate-turned-criminologist explains, prison gangs in California “control the contraband distribution systems, prison politics, the public areas of the prison, and any pan-prison activities...[and] to circulate in this world...one must...with a few exceptions, have some type of affiliation with a powerful racial clique or gang” (Irwin 1980, 195). For Hispanic inmates in particular, “Chicanos in large California prisons – Soledad, San Quentin, Folsom, and Tracy – must have at least a loose affiliation with one of the Chicano gangs” (Irwin 1980, 206).

3.3. Information Transmission Mechanisms

The information costs associated with impersonal exchange and large-scale enterprise is a notable challenge in self-governing communities. How does NF overcome this problem, which is especially severe given the constraints of the incarceration context? They face two related problems. First, they must be able to identify who is associated with the gang and has a claim to the group’s protective services. There are currently roughly 170,000 inmates in thirty-three

CDCR prisons; thousands of new inmates enter each month; and officials regularly transfer inmates to different facilities. How do NF-affiliated inmates that arrive at a new prison prove their membership? Second, the gang must prevent individual members from misusing the gang's threat of violence or weakening the gang's reputation. The NF addresses these problems by developing an explicit process to obtain information about inmate activity, authenticate it, and communicate it to higher-ranking gang members. Information transmission mechanisms allow them to identify which inmates to protect and give gang leaders information for monitoring member activity.

NF assigns a leader in each correctional facility to organize Hispanic inmates into protective associations and to oversee their operations. A former NF member describes the responsibility of one particular gang leader, "Castillo was also authorized as the overall authority in charge of the Monterey County Jail, responsible for establishing a functioning household and making sure all NF members and associates were operating according to established procedures and recruiting" (Fuentes 2006, 121). When inmates arrive at a facility, the NF has protocols for obtaining information about the new inmate. Gangs send a questionnaire to an arriving inmate asking about his name, nickname, date of birth, neighborhood, street gang affiliation, criminal charges, associates who are incarcerated, and where he has served time in the past (Balassone 2010). The questionnaire becomes more thorough at state prisons than at county jails because the gang can rely less on local social connections for information about new inmates. Correctional gang investigators describe one such note found in an inmate's cell, "Further on in the notes, [inmate] gives a brief history of himself and identifies numerous other identified NF and NS associates and members. It appears that [inmate] is informing the security or squad leader who

[inmate] is and what he has done or accomplished” (Fuentes 2006, 84). The questionnaire is also often followed up with a face-to-face meeting with gang members (Fuentes 2006, 63-66).

NF members cross-reference the questionnaire with the “bad news list,” which records people who have been marked for punishment because of bad past behavior. A high-ranking member in each facility holds the bad news list, and other gang members often hold additional copies. The list typically includes names of gang dropouts, rapists, informants, and other inmates who have violated accepted rules of behavior. The bad news list details what type of punishment the inmate deserves, which can range from assault to murder.

New inmates usually have to wait several days before having their status cleared with the gang, at which time they can begin to integrate themselves more fully into the inmate social system. The NF may place inmates on a probationary period for several months (Fuentes 2006, 80). Prison gangs educate new inmates about their history, purpose, and goals, including requiring that they memorize written rules of behavior (Fuentes 2006, 66). One of the more prominent written guidelines for inmates is the “14 Bonds,” which outlines the permitted, forbidden, and obligated behaviors for a Hispanic inmate from Northern California while incarcerated.

When a gang member transfers to a new cellblock or facility, he provides information to the ranking gang members in the new facility about the status and activities of the gang in his former location. For example, when an inmate moved within a facility to a new secure housing unit he filed “a report with the NF’s overall authority in charge of that unit” (Fuentes 2006, 84), and when he was transferred to a new facility he “filed a full report pertaining to himself and his NF status, as well as a mandatory update regarding [California State Prison] - Corcoran” (Fuentes 2006, 88).

By establishing an explicit process for obtaining, authenticating, and communicating information, prison gangs can more effectively control inmates. They have well-established methods of keeping track of who does not adhere to accepted behavioral rules and what level of punishment violations warrant. They know which inmates violate property rights and act opportunistically in illicit trade. Prisons are by no means perfectly safe, nor are prison gangs benevolent and always respectful of the property rights of gang members and other inmates. However, given the context of incarceration and the state's inability or unwillingness to provide all of the governance that inmates demand, prison gangs provide an important service in the inmate social system.

4. NF Operates Outside of Correctional Facilities

In addition to providing governance behind bars, the NF extends its criminal enterprise to the outside world. A federal grand jury indictment describes the NF operation in the 1990s: "Outside of penal facilities, the Nuestra Familia was divided into geographic 'regiments' managed by 'regiment leaders'; these regiments served as the basic unit or crew through which the Nuestra Familia conducted much of its criminal activity" (United States v Rubalcaba et al 2001, 3). These street regiments are in charge of accumulating and investing funds, supporting the incarcerated members of the gang, and carrying out the organization's business.

Each geographic region establishes a "regiment familia bank" (FBI 2009: 9-10). Regiment familia banks integrate paroled NF members into profitable criminal activities. A summary of an informant interview explains the process: "an NF member getting out of jail is normally set up with a car, a gun, drugs, and some money. This 'set up' is supposed to get the

NF member ‘on his feet’ and in business for himself. Those who do not take advantage of this opportunity risk severe discipline” (Fuentes 2006: 231).

Facilitating communication was a central part of NF operations, especially for monitoring its non-incarcerated members. A federal indictment explains:

Maintaining discipline within, and allegiance to, the Nuestra Familia Organization was a constant concern and preoccupation of the Nuestra Familia leadership...To maintain discipline and allegiance, the Nuestra Familia leadership in Pelican Bay State Prison demanded frequent communication by members through assigned “channels”...Through such communication, the Nuestra Familia leadership remained abreast of the activities of members and associates inside and outside of correctional facilities and issued new rules and directives” (United States v Rubalcaba et al 2001, 4).

Smuggling letters and notes about gang activity into prison is one method of communication.

The gang also structures its leadership positions to reduce shirking. They have established ex-post punishments, including both monetary fines and physical assaults, for members who did not actively engage in gang business once released from prison (Fuentes 2006: 248).

In addition to integrating released members into productive activities, the regiment bank pays wages and provides for medical and legal expenses to NF members in that local regiment. In return, members must deposit a portion of their profits from both legal and illegal endeavors into the regiment familia bank. A federal indictment explains that all NF members and associates were required to pay twenty-five percent of proceeds from robberies, drug deals, and other crimes into the bank (United State v Rubalcaba et al 2001, 6). Regiment leaders have the responsibility to ensure that soldiers acquire “at least two firearms (one of which would be donated to the regimental armory), [obtain] a cellular phone, and [accumulate] no less than \$500 on a monthly basis, which [is] put towards building the regimental bank” (Fuentes 2006, 173-174). Gang correspondence explains, “Those who are appointed to function as [a regiment commander] are also responsible for the building up of a familia bank, with no less than a

\$10,000 minimum” (Fuentes 2006: 90). The NF leadership requires regiment commanders to meet fixed percentage goals of growth for the regimental bank, creating an incentive for regiment captains to monitor the productivity of lower-ranking members.

An important component of the regiment commander’s job is to monitor the activities of lower-ranking members on the streets and communicate incarcerated leaders’ orders and policies (Fuentes 2006: 173). Regiments are constrained to a particular geographic region, so regiment leaders can observe operations and access local social networks to obtain information on members’ productivity. Correspondence between two high-ranking NF leaders explains that it is the regiment commander’s job to “see that all ventures undertaken are planned effeciently [sic]” (Fuentes 2006: 90).

Regiment leaders have authority to mediate conflict within the organization. High-ranking members “were responsible for establishing regiments and gang policy, resolving intra-gang disputes among members and associates of the Nuestra Familia, approving new memberships in the organization and authorizing significant actions by members of the Nuestra Familia and Nuestra Raza, including the commission of murder” (United States v Rubalcaba et al 2001, 3-4). Internal conflict is costly because members use resources to transfer wealth from other members (or defend against wealth transfers) instead of engaging in criminal profit seeking. The regiment captain, who has relatively good information about the personalities of his members and the details of the circumstance, can effectively adjudicate intra-group conflict. The incarcerated leadership sets broad guidelines that limit the discretion of the regiment leaders and guide their managerial actions. In one instance, for example, the gang’s leadership demoted a regiment leader who was not strict enough and replaced him with a more disciplined member (Reynolds 2008).

5. Conclusion

The legal centrism hypothesis argues that the state is required to define and enforce property rights, and that in the absence of doing so, self-governing groups will be unable to engage in economic exchange and extended commercial operations (Stringham 2015). The success of the Nuestra Familia prison gang provides evidence to the contrary. This group is composed of people who have high discount rates and are actively disrupted by the government, yet they secure property rights for many inmates behind bars and they effectively conduct business outside of prison.

Most of economic research assumes that property rights are clearly defined and fully enforced. Research in law and economics has brought this assumption into the foreground and analyzed it explicitly. Related work from a market process perspective emphasizes two concepts that are usefully studied in illicit contexts. First, the market process focuses on exchange behavior and the institutions in which it takes place. Because criminal groups cannot rely on state-based institutions, they must devise their own governance solutions. This provides the opportunity to understand when institutions succeed and why they fail. Studying how people capture the gains from trade and how it differs across contexts suggests the robustness of self-enforcing exchange institutions. Second, social institutions are often the result of human action but not human design. In the incarceration context, the conditions that led to the rise of prison gangs resulted unintentionally by the actions of numerous people. Choices made about the capacity of correctional facilities, federal and state laws about what is a crime and how it will be punished, the composition of inmates, and correctional officers daily actions led to an environment where inmates lacked secure property rights. Prison gangs formed first to protect

themselves, but once they were able to do this, they found that they had an advantage in engaging in illicit trade. Given the constraints, prison gangs were the most effective providers of governance in the inmate social system.

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