

INSTITUTIONAL REFORM AND PUBLIC ECONOMICS: THE CASES OF THE OLD AND THE NEW INSTITUTIONAL ECONOMICS (*)

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1 — Introduction

Though the expressions «institutional organization matters» or «institutions matter» are some old ones, most scholars in economics, particularly those making general theories and models, have not paid much attention to the many and diverse institutional aspects surrounding those human economic affairs taking place in markets, political processes, and other arenas. Exceptions to the above assertion are, among others, scholars such as those working under the approaches of *Old Institutional Economics*, *New Institutional Economics*, and *Public Choice-Constitutional Political Economy*. In all these camps, most contributions usually provide us with explanatory analyses of the impact of institutional-constitutional rules upon economic events, and also of the public decision making processes leading to institutional-constitutional reform. Normative assessments of the working of different institutional arrangements are also frequently found among those contributions. The collective/political nature of decisions leading to institutional creation and reform, as well as the character of most institutions and rules under investigation allows us to place many of the said analyses into the broad camp of Public Economics.

The purpose of the present paper is to investigate the way in which two of the said groups of scholars, that is old institutional economists and new institutional ones, conducts their research task and elaborate their theories and models about institutional changes and reforms. I want to find and show whether they adopt similar or different methodological assumptions, criteria and methods for so doing, and how these methodological choices conforming their respective approaches affect their explanatory analyses and their normative assessments and proposals for reform. Though the paper deals with institutional reform and many insights are provided when comparing the said contributions, it is basically organized as an exercise in applied and comparative methodology.

Once their respective methodological assumptions, criteria and methods have been presented and assessed, and the consequences of those methodological choices revealed, a straightforward conclusion follows. That is, old and new institutionalist analyses of institutional changes are built upon two different approaches because their respective methods of analysis (holism versus methodological individualism) are different and, above all, because they are built

(*) A preliminary draft was presented at the VII World Congress of Social Economics and the 1st Iberian Conference on Public Economics (ISEG). In Toboso (1995) similar ideas are presented in order to answer the question: Can we retain the image of reality contained in a model if we change its methodological foundations?

on some concepts that are mutually exclusive (concepts showing power/non-voluntary influences versus concepts showing voluntary transactions). While old institutional analyses are usually oriented to account for distributional aspects, new institutional ones recurrently emphasize efficiency considerations. Their analyses contain different and, in many cases, mutually exclusive images of the institutional changes that take place and greatly affect human economic matters.

The paper is organized as follows. In section 2 I pay attention to three basic methodological assumptions and methods commonly adopted by many old institutional economists that are usually referred to as *holist method*, the *power conceptualization*, and the *distributional conflict perspective*. In section 3 special attention is paid to the approach characterizing transaction costs-new institutional economics contributions, in which, among other differences, the *holist method* is replaced by the method of *methodological individualism* and the *power conceptualization* is replaced by a *voluntary conceptualization*, and the *distributional conflict perspective* is usually replaced by an *efficiency perspective*. New institutionalists are also known for their adoption of transaction cost concepts. In section 4 some examples of their respective explanatory analyses and proposals for reform are presented and compared in order to reveal how the said methodological choices affect the results of their research task. Section 5 contains a brief conclusion.

2 — Some methodological foundations of Old Institutional Economics

As must be known, it is sometimes asserted that nothing else apart from radically critical analyses and unorganized descriptive materials can be found in the contributions elaborated by old institutional economists, who seem to share some philosophical conceptions of the German Historical School. It is more frequently asserted that their contributions do not qualify as a well-established Kuhnian paradigm nor as a mature Lakatosian scientific research program⁽¹⁾. However, I want to argue here that, particularly in the last twenty years, I see the old institutionalists making a renewed effort to deep into and explicitly point out the methodological bases and conceptions they usually share in doing their research task⁽²⁾. May we derive any conclusion from these efforts? I think so⁽³⁾. I think it is possible to point out a minimum set of compatible methodological

(1) The image of science respectively elaborated by these authors may be found in Kuhn, T. S. (1962), and Lakatos, I. (1978). It must be reminded that while Kuhn intended to build an image based on actual practices of scientists, Lakatos did not necessarily.

(2) This renewed effort has been greatly stimulated since the foundation of the Association for Evolutionary Economics and the *Journal of Economic Issues* in the sixties. It has been advanced further, despite the tension and the conflict generated, by the foundation of the Association for Institutional Thought and the *Journal of Institutional Thought* in the seventies. And it has recently been supported by the foundation of the European Association for Evolutionary Political Economy in 1988. Recent papers dealing with several events in the history of the institutionalist school are Bush, P. D. (1991), Klein, P. A. (1990), and Ranson, B. (1981).

(3) One of the latter papers published in the *Journal of Economic Issues* that comes to a different conclusion from this one I am going to express here is Lind, H. (1993). Although it poses a very interesting question, the paper is seriously flawed because of the procedures followed in order to answer it.

foundations which are usually present in many institutionalist contributions dealing with the task of explaining the process of institutional change. It must not be deduced from this statement, however, that differentiated positions and incompatible analyses cannot be found among the institutionalists⁽⁴⁾, nor that methodological monolithism is a desired requirement for doing research⁽⁵⁾.

Which are, then, the basic methodological foundations upon which many old institutionalists analyses about institutional changes are built? They are the *holist method*, the so-called *power conceptualization*, and the *distributional conflict perspective*.

To refer to the first one, terms such as *methodological collectivism* and *functionalism* have also been used with a sometimes slightly different meaning. Gruchy, A. (1947), is considered the pioneer among the old institutionalists in introducing the term *holism* to characterize institutionalist contributions. On the history-philosophy of sciences camp, it was in the last sixties and the early seventies that the last big debate on how should be explanations in the social sciences took place, particularly confronting what are considered two extreme modes-methods of explanation-analysis: the *psychologistic methodological individualism* and the *methodological holism/collectivism*⁽⁶⁾. I think it is obvious that the traditional neoclassical general theories are usually elaborated upon the first of these methods. For most institutionalists, however, this mode of explanation-analysis is not considered a proper one in dealing with the research questions they usually want to answer⁽⁷⁾, but we are not interested here about this method.

On the contrary, we want to pay attention to the methodological collectivist mode of explanation upon which many institutionalist analyses on institutional change are built. Which are then its main characteristics? As a way of briefly but accurately presenting the topic, I can say that, to adopt this method implies presupposing that individual actions are only properly understood-explained if individuals are considered parts-components of some other *entity(s)*, being the position they occupy a basic factor in determining the values, ideas, knowledge, preferences, purposes and constraints faced by them. Then, analyzing human actions and interactions and the generated events means paying special attention to those *entities* (groups, associations, corporations, political parties, churches, cities, states and other organizations and institutions) to which most of the individuals belong to, most of the time, as passive members who assume (we do not now specify how) the purpose, values, rules, norms, etc., usually established long before as a distinguishing mark of the *entity-organization-institution*⁽⁸⁾. It is

(4) Significant methodological debates among the old institutionalists may be found in Bush (1991), Ramstad (1989), Gruchy (1989), (1990), Whalen (1989) or Tool (1987).

(5) Arguments in favour of methodological pluralism and problem-dependent methodology may be found in Boland, L. A. (1982), part iv, and Caldwell, B. (1984), chapter 13.

(6) On this big debate see the collections of papers published in Krimmerman, E. (1969), Brodbeck, M. (1968), O'Neill, J. (1973), and Lakatos, I., & Musgrave, A. (1968).

(7) Recently published examples of this position may be found in Hodgson, G. (1988), (1986), (1985), Field, A. (1984), (1979), Bush, P. D. (1981), and Dugger, W. M. (1979).

(8) In a coming section we will make a conceptual differentiation between organizations and institutions which is not necessary for our purpose now. As elementary examples of this greatly passive membership, think about the formal associations you entered into when they had already been long established, even if you may be more active in promoting institutional changes than the median member.

because of this that these collective *entities*, social *entities* or institutions take such a central position in the old institutionalist contributions and that it is even sometimes asserted that these entities have objectives of their own, usually established long before by individuals that may even be dead. And, it is so when those objectives and rules remained written, and also when they were only kept in the minds of the founders and were orally transmitted. We are not paying attention now to the mechanisms established to enforce these objectives and rules. But old institutionalists are also interested in analysing-explaining the changes that take place in these *entities*-institutions. To examine the image of institutional change they build is one task of this paper, as is surely remembered. In explaining-analyzing institutional changes with a methodological collectivist mode-method, institutionalists are also required to pay special attention to the position the evolving institution occupies in the overall institutional structure, as well as the position occupied by other *entities* that might benefit from this evolution or change. The actions of the individuals involved are only properly understood-explained if the position they occupy in the institutional structure, and how it affects them, is taken into account⁽⁹⁾.

Of course, the holist-collectivist mode of explanation leads to the elaboration of very abstract analyses in which many concepts and arguments that do not have an empirical counterpart (directly or indirectly observable) are used. This makes the task of refuting those analyses an even more difficult task than usual (even in a comparative and sophisticated Lakatosian way). The autonomous-impersonal social forces and factors appearing in old institutionalist contributions are an example of that⁽¹⁰⁾.

A second methodological assumption of old institutionalist contributions on institutional change is the so-called *power conceptualization*, which is much related with the third one we have called *distributional conflict perspective*. Neither of them is a mode of explanation but a set of concepts or analytical categories that imply concrete preconceptions and that greatly affect the *image* of reality offered to us in the analyses so elaborated. It must also be obvious in this case that *traditional* neoclassical general theories about the market are not elaborated using power concepts-preconceptions except in rare and anomalous situations such as that of the monopoly⁽¹¹⁾. They are built, on the contrary, using what may be called a *voluntary*, and usually *static*, maximization perspective⁽¹²⁾ which leads to approach the object of analysis through a set of con-

⁽⁹⁾ For a deeper examination of the methodological collectivist mode of analysis concerning institutionalist contributions see Ramstad, Y. (1986), Wilber Ch. K. Harrison R. S. (1978), Petr. J. L. (1984), and Langlois, R. (1989). See also Danto, A. C. (1965), Agassi, J. (1958), (1975), Hempel, C. G. (1968), and Harsanyi, J. C. (1969), and Cohen, G. A. (1982).

⁽¹⁰⁾ Some old institutionalists such as G. Hodgson (1989), (1986), and (1993) suggests the replacement of the «crude holism» by a more individualist method such as the *institutional individualism* of J. Agassi (1975). For a critical examination of the holist method of analysis see J. Elster (1982).

⁽¹¹⁾ On this assertion see Bartlett, R. (1989), chapter 1.

⁽¹²⁾ More recently, since the theory of games' tools are being extended all over, several analyses are built combining a voluntary and strategic maximization conceptualization with the rest of standard neoclassical assumptions. See Schotter (1981) and (1986).

cepts-preconceptions that only allow the scholar to account for voluntary actions and interactions between free individuals, that is, voluntary exchanges.

In the old institutionalist contributions elaborated upon the *power conceptualization*, however, the transmitted image of the market processes (as well as other processes and institutional changes) is a different one from that other mentioned above. Instead of a picture in which where consumers appear making free choices in the supermarket, or where potential traders freely make offers in order to reach an agreement, or where a potential employee also freely decides to accept or not any of the available jobs, to mention just a few elementary examples, in the old institutionalist contributions concerning the market processes, by contrast, the picture is one in which, for example, consumers arrive at the supermarket greatly influenced in their values and preferences by the power of the *big corporations* and their control of the mass media, where consumers are many times compelled to choose between A, B and C versions of a product but they cannot replace their D version which is no longer produced by the *firm*, or one in which unions attempt to increase their bargaining power when confronting the bargaining power of the *corporation* ⁽¹³⁾. As already stated, old institutionalists also use power concepts in their analyses of institutional changes but we leave the investigation of the image so offered for section 4 when comparing it with the image of institutional changes offered by the so-called transaction cost-new institutional economists. Here, we only have left to emphasize that, as is obvious in the examples just given, the *holist method* and the *power conceptualization* work together. And this means that in explaining-analyzing the sources of power, the process of power influences, the impacts of power, etc., special attention is given to the specific *entities*-institutions always present, to the positions individuals occupy in them, and to the overall institutional structure under which the phenomena to be analyzed take place. Autonomous and *supraindividual* powers are usually basic factors in those contributions. The limitations mentioned above apply also here.

Finally, in most old institutionalist analyses of institutional organization and change the authors are always attempting to reveal the distributional impacts originated by the existing institutional structure under investigation or as a consequence of the institutional changes occurred. What they call the systemic struggles of power usually appear in their theories much related to distributional conflicts between groups, sub-systems or *entities*. Those distributional impacts are main aspects taken into account when they make normative evaluations. Their proposals for institutional reform also are much influenced by their said normative position in favor of redistribution of income and wealth, as well as, instrumentally, of power ⁽¹⁴⁾.

⁽¹³⁾ Examples of these systemic analyses of market processes using power concepts may be found in Dugger, W. M. (1980), Samuels, W. J. (1972), Galbraith, J. K. (1972), (1978), Hickerson, S. R. (1982), Samuels, W. J. (1979), Tool, M. R., and Samuels, W. J. (1989), and Tomas-Carpi, J. A. (1992).

⁽¹⁴⁾ For a deep consideration of their «social value principle» as a normative criterion for policy recommendations see Tool (1977), (1979) and (1986) or Hickerson (1987).

3 — The alternative methodological foundations of the New Institutional Economics

Let us go with another step in accomplishing the task at hand. As mentioned in the introduction, there is another group of economists that are working closely with each other and systematically debating their progressions. They have called themselves new institutional-transaction cost economists in order to emphasize their main research preoccupations. Although this intellectual movement has Ronald Coase as one of its leaders and the classic works of Coase, R. (1937), and Coase, R. (1960), as inevitable references together with the contributions of the property-rights theory in the sixties and seventies, it has been in the eighties that this movement has acquired its distinguishing characteristics, particularly since the international seminar series on the «New Institutional Economics» began in 1983 and these debates were published in the *Journal of Institutional and Theoretical Economics* (15). It must also be said that though several scholars closely related to the Public Choice Center and the Virginia school actively participate in these debates, the new institutionalist contributions represent an emerging research program differentiated from the public choice one (16).

Which are the basic methodological foundations commonly shared by the new institutional-transaction cost economists? Let me say here also that, as it was the case concerning old institutionalist contributions, it is not the purpose of this paper to deal with and take a position on the methodological debate that is taking place among the new institutionalists, even if their own reflections reveal that there still are too many methodological aspects to be discussed (17). In this

(15) For further information about the antecedents see Scott, K. E. (1984), Heijdra, B. J. (1988), Williamson, O. E. (1990), (1985a), and Eggertsson, T. (1990). Recently, an International Society for the New Institutional Economics has been formed.

(16) Ch. Rowley, V. Vanberg, B. S. Frey are some of those participants. Further information about the methodological foundations of public choice theory may be found in Toboso, F. (1990), (1991), (1992), (1993) and (1994). Some misinterpretations may be originated by the fact that both movements share some areas of concern and some methodological foundations, and also by the ambiguous and sometimes contradictory declarations published from the initial debates. While Furubotn, E. (1984, p. 3), refers to J. M. Buchanan and the public choice literature as something totally compatible to what new institutional economics should be when applied to constitutional choices, this same author, in his editorial preface of 1989 (Furubotn, E., 1989, p. 3) explicitly rejects de Pareto efficiency criterion J. M. Buchanan uses in dealing with constitutional reform. More recently, referring to his own version of the new institutional economics, North, D. C. (1990, p. 140), has explicitly told against the public choice approach and the tools of the game theory, while in North, D. C. (1986, p. 235), he ambiguously stated:

The new institutional economics that I have briefly described in the foregoing section builds on the literature of transaction costs, property rights and public choice, and it requires integration of this three bodies of literature.

It is no doubt that personal ideas also evolve and change. We will say more on this latter on.

(17) For example, Furubotn, E. (1984, p. 3), identified the methodological foundations of the new institutional economics with the «traditional foundation stones of neoclassical theory-viz., *methodological individualism* and the *self-interest principle*», while Williamson, O. E. (1984b, p. 197), in the same volume of JITE says: «bounded rationality is the cognitive assumption on which transaction cost economics relies». Eggertsson, T. (1990, p. 10), offers a much criticized differentiation between «neo» and «new» institutional economics.

sense, the editor of the international seminar series, Furubotn, E. (1993, p. 8), has stated:

If it was thought previously that the work of the new institutional economics could be accomplished simply by extending neoclassical theory, there is reason today to believe that something more is required. [...] Some insights yielded by neoclassical analysis will continue to be valuable, but theoretical movement seems likely to be in the direction of a more flexible and comprehensive model of political economy.

Nevertheless, I am going to be as constructive here as I was in the case of old institutional economists to state that three basic methodological foundations commonly shared by many new institutional economists when analyzing institutional changes are the *methodological individualism* mode of explanation, the so-called *voluntary conceptualization*, and the *efficiency perspective*, being much related the latest two⁽¹⁸⁾. They are also well-known by their emphasis on adopting transaction cost concepts, though not everyone self-labeling himself new institutionalist adopts this foundation as I am going to comment next. They usually combine also the *methodological individualist* mode of analysis and the so-called *bounded-procedural rationality assumption*⁽¹⁹⁾. As they themselves have written, when, by contrast, full information-unbounded rationality is assumed, transaction costs may be disregarded because this concept is defined as the cost of measuring the different aspects of the options available for action, the cost of negotiating the terms of the exchange-contract selected, and the cost of enforcing these terms once established. Even if discussions always appear in deciding who is going to settle what is full and what is less than full information in every situation, one could logically imagine that if full information existed for all agents, and they also had no cognitive-processual limitations, none of these costs would be relevant because the processes that generate them would be, under the assumption-s made, almost automatically-instantaneously solved and then transaction costless by conceptual definition. So then, in referring to the *transaction cost conceptualization* of the new institutionalists, an implicit reference is also usually made to the *bounded rationality assumption*. As known, many neoclassical economists usually adopt the *full information-unbounded rationality assumption* when building their general theories⁽²⁰⁾.

These methodological differences from the *traditional* neoclassical analyses allow the new institutionalists to offer new insights and a differentiated image of

⁽¹⁸⁾ Declarations of the importance of these foundations may be found in Williamson, O. E. (1984b), (1985a), (1990), Langlois, R. N. (1986a), and Furubotn, E. (1990). Among the new institutional economists, the economic historian and Nobel prize winner 1993 D. C. North represents the position more clearly differentiated, particularly in his last publications North, D. C. (1993), (1991), (1990), and (1988), and because of that he is the one who fits the worst in the simplified view sketched here. In section 4 I will refer to D. C. North again.

⁽¹⁹⁾ On the *bounded rationality assumption* see Simon, H. A. (1979), (1978), Langlois, R. N. (1986a), (1990), Setten, R. (1990), Hart, O. (1990), Schlicht, E. (1990), and Lindenberg, S. (1990).

⁽²⁰⁾ On this point see Hutchison, T. W. (1984), Coase, R. H. (1984), North, D. C. (1990), and of course Coase, R. H. (1937).

the many market processes that neoclassical analyses usually deal with⁽²¹⁾. And, what is more important to us here, new institutionalists also attempt, among other things⁽²²⁾, to deal with the institutional changes that take place and significantly affect economic performance. All this no doubt makes a difference from neoclassical contributions but there are also significant similarities that we must not disregard if a complete but simplified view of the new institutional economics is to be transmitted.

If I have just said that the new institutional approach methodologically differs from that of the *traditional* neoclassical economics, I am going to emphasize now that it differs much more from that of the old institutional economists sketched in section 2 of this paper. Furthermore, the new institutional-transaction cost economists have themselves dedicated some of their time to explicitly remark that the antecedents of this new movement cannot be found in the old institutionalism and their modern successors, though both camps share some areas of concern⁽²³⁾. They have also repeatedly expressed that their intention is to extend neoclassical microeconomic theory by relaxing some of its core assumptions in order to incorporate institutional factors and organizational aspects into their theories⁽²⁴⁾, though the eminent new institutionalist E. Furubotn (1993, p. 8) has recently shown the doubts just mentioned. All these comments serve as a further endorsement of our conclusion.

How important are the existing methodological differences between old institutional economics and new institutional economics? They are so important that we can refer to them as two different and mutually exclusive approaches. And the central role in this differentiation is played by the *power conceptualization* that is usually adopted by old institutional economists and is absent in new institutional contributions which, on the contrary, are elaborated upon the so-called *voluntary conceptualization*. Despite their methodological differences from the traditional neoclassical approach, the new institutionalists share with neoclassicals this last methodological foundation mentioned. The contributions of both groups are built upon a *voluntary* maximization approach, though in the case of the

(21) As examples of these new images of some market processes, see the contributions by Williamson, D. E. (1975), (1985b), and Nelson, R., & Winter, S. (1982).

(22) Some others distinguishing characteristics that we do not consider in this paper relate to their attempt to incorporate institutional factors into their general economic theories and their emphasis in making comparative-static analyses of the consequences of institutions. On this, see Anderson, O. W., and Breng, K. (1992).

(23) Sometimes this demarcation is accompanied with comments such as those of R. H. Coase (1984, p. 230):

American institutionalism is a dreary subject. [...] All it had was a stance of hostility to the standard economic theory. It certainly led to nothing. G. Gafen in the discussion suggested that the modern successor to the American Institutionalists was Galbraith and perhaps this is comment enough. [...] Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory, or a fire.

(24) Statements in this sense may be found in Coase, R. H. (1984), Langlois, R. N. (1986a), Hutchison, T. W. (1984), and Williamson, O. E. (1984b), (1985a). O. E. Williamson likes to make ambiguous references to J. R. Commons to fall down immediately after into the habitual stereotypes, as in Williamson, O. E. (1985a), p. 187, or Williamson O. E. (1990), p. 63.

new institutionalists the maximization is assumed to be rationally bounded and strategic and, consequently, with positive transaction costs. To build models and theories of institutional change upon power concepts or to build them upon concepts that only allow us to show voluntary interactions or transactions is a radically different intellectual activity which leads to a radically different *image* of the institutional changes under investigation. When assessing those changes, new institutionalists are primarily interested in determining whether the transaction costs associated to the institutional framework under investigation are being reduced by the change or not. *Ceteris paribus*, reductions in transaction costs means *efficiency gains*. This is the *efficiency criterion* much used in new institutional contributions. Their propensity is to model institutional changes as if they were a result of individual efforts to reduce the transaction costs they suffer, which transmits a very positive image of those changes ⁽²⁵⁾.

It must be noticed here that when referring to the *voluntary conceptualization* I am not pointing out the maximization or rationality aspect of human actions. Neither am I referring to the differences between old and new institutionalist analyses that are a result of the different modes of analysis employed, though they are important too ⁽²⁶⁾. I am interested here, however, in emphasizing and briefly comparing the differential impacts over the *image* of institutional change that are generated as a result of alternatively using a *power conceptualization* or a *voluntary conceptualization*. In order to show these specific differences, it is worthwhile to group the analyses according to the type of institution they deal with. Let us go to compare first the *images* of change concerning informal institutions-social norms first, and then we will do the same for formal institutions-legal rules.

4 — Some examples of analyses about institutional change and reform from both camps

In this sense, we can first say that there are an increasing number of these new institutionalist contributions on institutional change which particularly deal with change in what is called informal institutions, social institutions, social norms or social conventions. Schooter, A. (1981), (1986), Vanberg, V. (1988a), (1988b), Ault, R. W., & Ekelund, R. B. (1988), and even most of Witt, O. (1989), may be pointed out as some examples ⁽²⁷⁾. In these works, the central focus of interest is put on explaining-analysing the emergence, the change and the effects of social norms-informal institutions such as «to settle disputes among gentlemen by dueling», «not to defect», «to rapidly pay doubts», «to keep your word», «to

⁽²⁵⁾ Hodgson (1991) has named this research procedure as a panglossian approach which mechanically attributes efficiency qualities to the institutional changes we see.

⁽²⁶⁾ G. Hodgson (1989), (1986), (1985), A. J. Field (1981), (1986), (1979), Langlois, R. (1989), and Rutherford, M. (1989), have partly accomplished these other tasks. In order to concentrate ourselves on the *power conceptualization* versus the *voluntary conceptualization*, we do not comment here on those tasks. In section 2 we made some comments on how the mode of explanation-analysis used by old institutionalists affects the image they build.

⁽²⁷⁾ A related but differentiated contribution is Nelson, R. R., and Winter, S. G. (1982).

help your neighbor», «to always drive along the same side», and many other traditions and customs that are, basically, behavioral rules widely respected by the members of a community. These widely shared informal institutions or behavioral rules lead to what is labeled in this literature as rule-following behavior on the part of individuals, as opposed to the case-by-case maximizing calculation of traditional neoclassical analysis on market processes.

The point to be emphasized here is that the new institutionalists usually explain the emergence and change of these behavioral rules as a result of deliberate and voluntary personal decisions taken by most, if not all, of the individuals of a community. Often, the *image* of institutional change contained in these contributions shows us that it takes a long time for the behavioral rules to gradually evolve and change. In some other cases, specific characteristics of an informal institution are presented as rapidly changing because of an imitation process on the part of the individuals when confronted with new circumstances.

Among those self-labeled new institutionalist contributions, we can find some works where the emergence of these behavioral rules is explained with an approach explicitly based on the psychologistic methodological individualism mode of analysis here attributed to the traditional neoclassical contributions and, because of that, not fitting very well in the methodological presentation of the new institutional economics given in section 3, though they still are built upon the *voluntary conceptualization*. This is the case, for example, of the *image* contained in those contributions dealing with the emergence of the «to cooperate if others do» behavioral rule in which unbounded rationality-complete information, small number of participants and repeated game interactions are assumed. Under these assumptions it seems rational for individuals to adopt this rule of behavior instead of being calculating on every occasion whether or not to cheat in their transactions with other members of the small community. The free-rider problem gets eliminated⁽²⁸⁾. Obviously, this *image* of the emergence of informal institutions does not account for aspects so important in standard new institutional contributions such as transactions costs, information limitations, and limited cognitive abilities on the part of individuals implicated. The *abstract maximizing individual* mentioned in G. Hodgson (1989) continues to be the central tool of analysis, together with some other concepts of game theory. However, among the new institutionalist contributions we find also many other works that fit better in the methodological presentation of new institutional-transaction cost economics given in the present paper. The *image* of institutional emergence and change here elaborated rest upon most of the methodological foundations mentioned in section 3, that is, the *methodological individualism* mode of analysis, the *voluntary conceptualization*, and the *transaction cost conceptualization-bounded rationality assumption*. If positive transaction costs-bounded rationality is assumed to exist, it may be a reasonable decision for an individual to voluntarily adopt a behavioral rule which in his own opinion proves to yield good average results

⁽²⁸⁾ Examples of this image and the foundations upon which it has been elaborated may be found in Axelrod, R. (1984), and (1986).

instead of incurring the transaction costs and risks implied by the case-by-case strategic maximization and all its requirements⁽²⁹⁾. If other members of the community arrive at the same conclusion or simply imitate such a profitable strategy, the initially personal rule of behavior may become an informal institution which endures through time and passes on from some individuals to others. In the *image* contained in these contributions, this informal institution may be gradually modified or altered if new circumstances systematically and increasingly led individuals to perceive the average results as more and more disappointing⁽³⁰⁾.

Transcending all peculiarities, what is important to emphasize here is that all these contributions are elaborated upon a *voluntary conceptualization*. In this image, individuals appear *voluntarily* deciding what behavioral rules (social norms, social conventions, etc.) they are going to follow and when they are going to change them. This is a radically different *image* of these phenomena from that other which is contained in old institutionalist contributions and is built upon power concepts. Let us give some examples of the latter before coming to compare the *images* of changes in formal institutions.

As W. T. Waller (1988) points out, when old institutionalists refer to this kind of phenomenon we are now dealing with, they usually focus their attention on what they generally call social habits. The emergence of shared habits and their gradual alteration constitutes a major theme of research concern to old institutionalists since the times of Th. Veblen and J. R. Commons. Though in investigating these phenomena, present day old institutionalists such as W. T. Waller (1988) himself, G. Hodgson (1993), W. M. Dugger (1980a), and some others have enriched the set of concepts they inherited from these and other pioneers⁽³¹⁾, the basic methodological foundations mentioned in section 2 have remained in most, though not all, of their contributions. To use *holism/methodological collectivism* as the basic mode of explanation-analysis together with power concepts in the task of building the most accurate *image* of the emergence and change of informal institutions means paying special attention to the power influences individuals receive because of the position they take in the overall institutional structure, both their positions in the existing formal institutions (as sources of power influences), and their position concerning the habits and social norms that prevail among the members of the several organizations they belong to. Individuals' values, goals and preferences appear in these institutionalist contributions greatly moulded by these power influences emerging from the institutional structure, and so are the behavioral rules or social norms individuals follow when acting in their daily activities: shopping in the supermarket, deciding how to use their leisure time, eating at an embassy reception, or at-

⁽²⁹⁾ As it must be obvious, in this paper we do not pay attention to some other very different contributions that conceptualize some types of behaviour as a result of addition problems, small temptations and other psychological mechanisms such as those pointed out by J. Elster. See for example Elster, J. (1983), and (1989).

⁽³⁰⁾ See Vanberg, V. (1988a).

⁽³¹⁾ While W. T. Waller (1988) differentiates between *routines* and *ritualized habits*, G. Hodgson (1993) does it between *routines*, *habits*, and *social norms*, and W. M. Dugger (1980a) talks about habits, roles and social mechanism such as *subreption*, *contamination*, *emulation*, and *mystification*.

tending a funeral, to mention just but a few examples. In the *image* contained in old institutionalist contributions, the adoption and change of these behavioral rules or social norms do not occur as a result of a deliberate and *voluntary* decision taken by each individual, who calculates (with bounded or unbounded rationality) which norms are more profitable for him, but a result of the power influences individuals receive in their never ending evolutionary process of learning. When an individual moves to a different institutional setting, he progressively gets influenced by the new behavioral rules or social norms that prevail in his new location, norms that replace the older ones when they become incompatible. Of course, a specification of the process of the power influences and the operating mechanisms that lead to this result is needed in order to complete the holistic argument. Mechanisms such as those highly abstract ones used by W. M. Dugger (1980a), (1988), and Hickerson, S. R. (1982), that we have just mentioned must be explicitly incorporated into the image-theory in order to make the holistic explanations logically consistent⁽³²⁾.

It must also have been noticed that I have not made any reference in the above comments to individuals exercising power influences. This is not by chance, but a result of my concentration here on strict holistic contributions in which we find statements so abstract as this one:

A corporate culture is a set of shared beliefs and values inculcated in the corporations employees. The corporate culture reinforces and reshapes the employee's general desire to do well into a compulsion to get ahead through loyalty to the corporation and through hard work for the corporation⁽³³⁾.

Or such as this one:

The following framework will place great emphasis upon the institutional structure and the individuals it produces. Only after grasping the relation between institutional structure and individuality can power itself be analyzed. [...] American economy contains six clusters of institutions [...]. Each of the non-economic clusters is linked to the dominant economic institution, the corporation, in a kind of means-end continuum⁽³⁴⁾.

The problems I pointed out in section 2 when considering the *holist mode of explanation* are also relevant here.

What can I say now on the images of change contained in those contributions that deal with formal institutions-legal rules? Let me say, first of all, that though sometimes the terms «formal institution» and «organization» are indistinguishably used, in analyzing institutional change, our explanatory precision is enhanced if we conceptually differentiate between them⁽³⁵⁾. In this sense, we

⁽³²⁾ For a debate on the importance of these mechanisms see Elster, J. (1982), Parijs, Ph.V. (1982), and Dorman, P. (1991).

⁽³³⁾ Dugger, W. M. (1988), p. 86.

⁽³⁴⁾ Dugger, W. M. (1980a), p. 898.

⁽³⁵⁾ A similar differentiation may be found in North, D. C. (1990).

can say that the formal institutions consist of the set of legal rules that every organization must have to exist. The rules contained in a political constitution, the rules and procedures by which a Central Bank is governed, and the rules of an economists' association are all examples of formal institutions that allow an organization of individuals to be formed. These formal institutions-set of legal rules, allow a group of people to form (or to be part of) a team, association or organization in order to interrelate to each other or to do things all together (in an organized and specialized assignment of tasks) which could not be done without such rules and the organization they create. But these formal rules also constrain behavior and, then, reduce discretionality, as it is the case of informal institutions-social norms, otherwise the coordination might not be effective⁽³⁶⁾.

Of course, individuals belonging to one or more of these organizations are not only subject to these formal-legal rules but also to other elemental behavioral rules or social norms that prevail among the members of each organization. We are here conceptually differentiating between formal and informal institutions, but it must be clearly stated, to prevent any misinterpretation of these concepts and comments, that people's interrelations through organizations are usually subject to both formal and informal institutions, formal-legal rules and informal-social norms. It is also possible and frequently observed that a person is affected by several sets of legal rules and social norms pertaining to a similar level, such as those of his tennis club and those of the association of parents existing in his children's school. And it is also evident that everyone is subject to institutions that are part of a more inclusive institution, such as the set of rules (formal and informal) of our family, the set of rules (formal and informal) of our resident's association, the set of rules (formal and informal) of our municipality, etc.

Once this conceptual clarification has been made, I want to emphasize that in analysing-explaining the change which takes place in formal institutions, old institutionalists and new institutionalists differ even more that they do when building the most accurate *image* concerning the emergence and change of informal institutions they can. It must be said, however, as has been already mentioned in footnote 22, that among the new institutionalist analyses of institutions there are many which simply consist of exercises in comparative statics and, because of that, will not be considered here.

Among the new institutionalist-transaction cost economists who sometimes deal with change in formal institutions, O. E. Williamson is one of the most prominent figures, if not the most. Because of the influence of his pioneer work *Markets and Hierarchies* on the transactions cost movement, as well as some others of his contributions⁽³⁷⁾, the new institutionalists have put special attention on analysing-explaining the emergence and change of the set of legal rules (including organizational forms) which characterize the organizations we call *firms* or *corpo-*

⁽³⁶⁾ This dual aspect of institutions is close to what J. R. Commons (1950), p. 21, wanted to stress in his a bit ambiguous definition of an institution as «collective action in control, liberation, and expansion of individual action».

⁽³⁷⁾ Special attention must be given to Williamson, O. E. (1975)'s work mentioned and to Williamson, O. E. (1985b), (1981), (1985a), (1984b), and (1990). See also the collection of paper appearing in Williamson, O., & Winter, S. (1991).

rations, assuming that they operate under the more inclusive competitive market rules, and leaving out of consideration all other formal institutions such as those of the polity which, as we know, are also subject to change and greatly affect the phenomena under investigation⁽³⁸⁾. It must be said also here that Williamson's contributions do not account for the many informal institutions that affect the phenomena under investigation such as those ranging from the general social norms of the country to the specific social norms existing among the members of a corporation. He himself has acknowledged that in his contributions there has usually been no room for social norms or cultural aspects and that this should be remedied. In O. E. Williamson (1984a, p. 69) he states: «this economizing mode of analysis pays little heed to the dignitarian side of organization. Whether that can be remedied within the context of the transaction cost framework or requires that the issue be viewed through an altogether different set of lenses remains to be seen». *Methodological individualism, bounded rationality, opportunism, and transaction costs concepts* are the central blocks of the *image* of change concerning organizational forms and other formal rules of the firm he elaborates, that is, the image of vertical integration and enlargement, of franchising, of introducing M-form principles of organization, etc.

However, what is more important for us here is that *voluntariness* is an always present characteristic implicitly or explicitly attributed to the transactions and changes under consideration, that is, to the changes in formal-legal rules that occur in corporations as organizations of many individuals.

These changes not only are usually conceptualized as a result of voluntary transactions but also as a result of a process leading to a reduction in transaction costs. The *image* so elaborated of these changes can be then assessed as an *image* that shows Pareto-efficient changes. That is, reducing transaction costs is efficient because it is assumed to be a voluntary process of change. That is what O. E., Williamson and others usually do⁽³⁹⁾, though some others such as D. North (1990) are moving away from this «efficiency view». Using voluntary concepts for building the most accurate *image* of change in formal institutions,

⁽³⁸⁾ Even the 1993 Nobel prize winner and also self-labeled new institutionalist D. C. North (1989, p. 240) has been explicit on this point when stating:

The major focus of the literature on institutions and transaction costs has been on institutions as efficient solutions to problems of organization in a competitive framework [Williamson, O. E. (1975), (1985)] [...]. Valuable as this work has been, it leaves out the most important contribution which institutional analysis can make to economics [...]. The formal economic constraints, property rights, are specified and enforced by political institutions and the literature that characterize modern industrial organization takes these as given. What we must do is to explore political institutions as well as economic institutions.

Reflecting the existing methodological debate between the new institutionalists, D. C. North states in one of his latter books [North, D. C. (1990), p. 28, note 2] the following:

[...] Other approaches, notably that of Oliver Williamson, will be contrasted with the approach developed here.

⁽³⁹⁾ As some examples see Williamson, O. E. (1975), (1985b) and (1981), and North, D. C., and Thomas, R. P. (1973).

as well as using concepts showing power influences, means to inevitably *impregnate* with some very subtle colours-values the *image* or explanatory theory that is being built. But to evaluate these changes as efficient changes is a different intellectual task that needs an explicit value criterion upon which to make the judgment or assessment. O. E. Williamson usually does both things when building his *image* of the transaction cost economizing characteristics of the evolving modern corporation. He builds his contributions upon an implicit *voluntary conceptualization*, and he explicitly attributes an efficiency quality or value to both the transaction cost economizing characteristics of the corporation when compared to market arrangements and to the transaction cost economizing changes in formal rules of the corporation which are showed in those contributions. All these *images*, even if every reference to efficiency qualities was eliminated⁽⁴⁰⁾, are radically different from the *images* of the working of modern corporations and their evolution or change built by old institutionalists because in the first case we see changes resulting from voluntary transactions between free individuals in an attempt to economize transaction costs while in the second case we usually see changes that come about as a result of the power of the *corporation* to adapt to new circumstances. In holist old institutionalist contributions, that power appears stemming from the overall institutional structure of the society and the changes do not usually make all affected agents better off, but only those who are in a position of control of the corporation⁽⁴¹⁾.

It must be said, nevertheless, that neither the old nor the new institutionalists have restricted themselves to exclusively investigate these changes in the organizational rules of the corporation. Many other changes taking place in formal institutions-legal rules are analysed, as is the case of the general legal rules that characterize the political system of constitutional democracies, or the specific laws and regulation norms which determine the types of markets that prevail in every society, for example. But, since the purpose of the present paper has already been achieved, we need not go on. Remember that the purpose is not to make a survey on old institutionalist contributions nor on new institutionalist ones, but to show their main differences in approach. The *power conceptualization* and the *voluntary conceptualization* are the mutually exclusive methodological foundations that draw a sharp division. Voluntariness is defined by the new institutionalists as the absence of power influences. For old institutionalists, power influences mean the absence of voluntariness. The *distributional conflict perspective* and the *efficiency perspective*, together with the other assumption mentioned, make the rest. All this has already been argued here with wearisome insistence, and examples of changes in formal and informal institutions from both camps have been compared.

⁽⁴⁰⁾ Critical examinations of this «efficiency view» explanations, see Dugger, W. M. (1983), (1990), and Schmid, A. A. (1987, chapter 11).

⁽⁴¹⁾ Examples of old institutionalist contributions containing these images, methodologically built as mentioned, may be found in the collection of works published in Tool, M. R., and Samuels, W. J. (1989), particularly the papers by Muller, R. (1975), Melody, W. H. (1985), and Miller, A. S. (1972). Usually, the changes are also evaluated using the so-called *instrumental value criterion*, and proposals for public action or reform are offered in order to achieve what institutionalists consider to be a more effective *social control* of corporations. On this criterion see Tool, M. R. (1979), Hickerson, S. R. (1987), and Sheehan, M. F., and Tilman, R. (1992).

5 — Brief conclusion

Old and new institutionalist analyses about institutional changes are usually built on two different approaches because, besides other differences, their respective methods of analysis (holism versus methodological individualism) are different and, above all, because they are built on some concepts that are mutually exclusive (concepts showing power/non-voluntary influences versus concepts showing voluntary transactions). While old institutional analyses are usually oriented to account for distributional issues, new institutional ones recurrently emphasize efficiency considerations. These two types of analyses contain not only different proposals for institutional reform but also different and, in many cases, mutually exclusive images of the institutional changes that take place and greatly affect human economic affairs. As it is the case in other areas of the social sciences, there is much camp here for debate and academic dialog.

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