

## OLD ORGANIZATIONAL ISSUES FROM A NEW INSTITUTIONAL ECONOMICS PERSPECTIVE. SOME INTRODUCTORY REMARKS

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The *images* of complex socio-economic realities that theories and reports transmit greatly depend on the methodological foundations upon which these economic analyses are built. Those *images* also depend on the specific procedures each group of researchers follow in order to test and refine their *explanatory* contributions. It is also evident that researchers from different traditions or schools often provide competing explanatory analyses, all methodologically and epistemologically biased. New criteria are also needed when the task requires to make assessments and policy recommendations, no matter whether this is done for free, as many scholars do as a part of their research duties, or for those who pay for an economic advice in order to better pursue their purposes, whatever they are. In social sciences, including economics, these are basic aspects characterizing research tasks.

Moreover, many economic articles, books and reports are being elaborated by authors that do not even try to play the *scientific game* of trying to find the most relevant explanation for the human affair under analysis. If economic transactions are always very much influenced by participants' expectations of future personal gains, then it seems straightforward that relevant participants will be interested in getting useful reports to advance their purposes in specific circumstances rather than just *true* reports. And so will their advisers, as well as similarly committed scholars. This applies to both scholars sympathetic to union leaders' bargaining strategies and scholars writing reports on alternative ways to reduce those transaction costs suffered by, for example, some cooperating firms wanting to coordinate their strategies against competitors. Many other examples could be mentioned.

What about the six papers included in this special issue? They can all be ascribed to the so-called New Institutional Economics (NIE) as they share those conceptualizations and methods much used now by scholars attending the annual meetings of the

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International Society for the New Institutional Economics (ISNIE). In what follows, some introductory comments on such a renewed perspective are provided. It is also stressed that distribution issues can be addressed through these analytical lenses, and some examples of so doing are mentioned.

As is well-known, Ronald Coase is one of the NIE founders, and his classic works Coase (1937) and Coase (1960) are inevitable NIE references, together with the contributions of the property-rights theory in the sixties and seventies.<sup>1</sup> However, it was through the articles and books published over the 1980s and 1990s that a more complete and coherent set of central core concepts, assumptions and criteria could in fact be gathered from the many self-labeled NIE contributions of the time. It was particularly so 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*.<sup>2</sup> In 1997, when the International Society for the New Institutional Economics (ISNIE) was launched, a long way had already been traveled by those hundreds of scholars who participated in the inaugural ISNIE meeting. Ronald Coase and Douglass North had already received the Nobel prize award.<sup>3</sup>

Of course, those events already belong to the NIE-ISNIE history. Historic are also those initial contributions mentioned in which transaction costs, property rights and few more concepts were combined in an attempt to just solve some limitations of standard neoclassical reasoning. As North (2005a), Menard (2004), Menard and Shirley (2005), Eggertsson (2005), Toboso and Arias (2006) and others make it easy to check, most analyses are now built on a much more comprehensive approach which Furubotn (1993, p. 8) already was able to envisage in the early nineties when he wrote that the future theoretical developments would likely be “in the direction of a more flexible and comprehensive political economy approach”. And it has turned out to be so concerning the analyses of transactions people take at different institutional frameworks. This is also the case concerning the articles that follow.

In current NIE contributions, authors systematically take into account the relevant sets of legal rules and social norms, as well as many other organizational details, influencing the human economic transactions under analysis. They often do so by trying to reveal how these arrangements affect transaction costs and the total output reached by participants. However, more and more attention is also paid to distributive issues as institutional arrangements also affect participants' share in that output. If team action is considered, now it is also evident for new institutionalists that arrangements used for organizing team action also influence the share in the efforts and costs needed to accomplish the common purpose. As several existing alternatives for reducing production and transaction costs will expectedly produce different distributional impacts on the affected participants, proposals for organizational reform are always a source of some dispute. In the polity this often causes conflict ending not in a general agreement but in a final vote with winners and losers.<sup>4</sup> Current NIE conceptualizations and methods allow for analyzing those situations in which some groups of people may oppose to a specific market institutional reform even when it is a generalized perception that total transaction costs could be reduced as a result.<sup>5</sup> In a similar sense, Horn (1995, p. 16) states that due to the fact that “enacting legislators' commitments, as well as the benefits

provided to their constituents, are uncertain when subsequent legislatures come, they may have an incentive to protect those benefits by even attempting to implement inefficient institutional arrangements that increase the transaction costs of reversing those policies".<sup>6</sup>

The strict reductionist rules of methodological individualism for building explanatory analyses are now followed only exceptionally as the rules of institutional individualism, a mode of explanation firstly depicted by Joseph Agassi,<sup>7</sup> are being widely used either explicitly or implicitly. This means that those relevant formal and informal institutional aspects affecting the transaction under investigation are usually taken into account as explanatory variables. This is also the case when the research task consists of explaining those changes in formal institutions that we see everywhere. Organizational reforms cannot appropriately be explained through non-institutional models as institutional arrangements, particularly the formal ones, are nested realities. There are always rules for reforming other rules. Some of them are written, others not. In many cases the informal ones are the most effective.<sup>8</sup>

None of these ideas are particularly new. They were already debated during the eighties and nineties as the papers from the seminar series on the NIE that were published in the JITE show. In fact, it was in the nineties that the NIE research program acquired its current distinguishing characteristics. Some articles and books by D. C. North during those years can help us to further explain the NIE approach and also show how it already departed from the neoclassical perspective at that time. In North (1988, 1990, 1991a, 1991b, 1993, 1995), for example, the *efficiency view* that characterized some of North's previous works was abandoned. Efficient changes are sometimes promoted and sometimes blocked in the political arena. Sometimes they are blocked for centuries, as the case of the medieval manor institution shows. In North's own words at those years: "Institutions are not necessarily or even usually created to be socially efficient, rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules" (North 1990, p. 16). He also abandoned his previous purpose of explaining all institutional changes in terms of self-interested human actions responding to changes in prices, technologies and natural conditions alone. Bounded rationality, as a behavioral assumption, entered North's analyses as well as many others.<sup>9</sup> Furthermore, it is through these publications that preliminary insights on the role mental models and ideologies can play were provided. His concern with cultural inertia and path-dependence should not surprise to anyone given that North is an economic historian.

Although capital accumulation and technological progress are relevant factors, the sources of contrasting economic performance between societies, he wrote, lie within the institutional structures that define incentives for saving, investment, production and trade and that also influence production and transaction costs. Because in standard neoclassical analyses most, if not all, institutional factors are removed and zero transaction costs are usually assumed, these analyses are of little help to North for explaining growth and development. Although North's analyses at that time were no doubt of an institutionalist kind, individual action remained essential for his explanations. Of course, individuals can act independently or they can coordinate

their strategies and efforts through organizations. People in organizations always try to profit from the existing institutional environment, but they also attempt to modify the given institutional structure in order to achieve a more favorable one.

Although this is not the place to carry out a survey, what seems evident is that more and more relevant insights are being provided as the approach is being made wider and wider, as indicated in the ISNIE website.<sup>10</sup> Recently, Williamson (2003) has stressed that, in contrast to the neoclassical resource allocation approach in economics, what NIE represents is a move from the lenses of choice under physical, monetary and technological constraints to the lenses of contract and organization for systematically analyzing people economic transactions and agreements of all kinds. North (2005, p. 21) has also stated that “in contrast to standard (neoclassical) theory that draws its inspiration from physics, modeling the process of change must derive its inspiration from evolutionary biology. But in contrast to Darwinian theory in which the selection mechanisms are not informed by beliefs about the eventual consequences, human evolution is guided by the perceptions of the players in which choices –decisions– are made... in pursuit of their goals”.

Transaction costs, credible commitments, modes of governance, persuasive abilities, social norms, ideological values, decisive perceptions, gained control, enforcement mechanism, assets specificity, human assets, social capital, asymmetric information, strategic behavior, bounded rationality, opportunism, adverse selection, moral hazard, contractual safeguards, surrounding uncertainty, monitoring costs, incentives to collude, hierarchical structures, bargaining strength, etc., are now analytical conceptualizations much used when considered relevant for the research task at hand, even if some concepts abound more in some research areas than in others.<sup>11</sup> If economic theories and reports must be relevant and instructive from the point of view of practitioners in firms, markets, governments, etc., they cannot be all built on an identical *ex ante* methodological jacket. Accounting for relevant particularities requires, of course, a methodologically consistent approach or research program formed by a set of basic *hard core* conceptualizations, principles, and criteria. However, it also requires a varied and wide set of *protective belt* concepts to choose from depending on the situation under investigation.<sup>12</sup>

These central core NIE conceptualizations and criteria are now being also much used in research areas in which fifteen years ago they were just marginal. New institutionally oriented journals have been launched, and an increasing number of books and articles are published each year as on-line search engines show, particularly in the English language. In the realm of development economics, for example, Barthan (2004) has recently written: “Earlier preoccupations with the forces of capital accumulation or technological progress have been widely replaced by a belief that the institutional framework of an economy is crucial for an understanding of the process of development or lack of it”. Several Annual Reports by the World Bank have also focused on the importance for economic development of general institutional arrangements.<sup>13</sup> And even Oates (2005), in a recent article entitled “Toward a Second Generation Theory of Fiscal Federalism”, refers to the lessons that can be obtained from NIE contributions.<sup>14</sup>

The papers that follow will surely persuade readers that old organizational issues transform themselves when viewed through the NIE varied set of lenses. That is, at least, the ultimate purpose of this special issue. Although the new pictures will mainly emphasize formal and informal institutional aspects, we should not forget that non-institutional realities are very important factors too for understanding economic performance in a village, a sector, a region or a country. Those formal and informal institutions that people build really matter, but they are not all. A key question we should not forget either is that institutions matter, but which ones? The analyses that follow clearly transmit the idea that different formal and informal institutional solutions for organizing similar transactions exist in different countries, regions, sectors, etc. They also show that formal institutions matter, but their impact upon economic performance greatly depends on the informal institutions shared by participants and on the relevant non-institutional circumstances that exist. Let us see how persuasive the papers are.

In a first paper Thrainn Eggertsson focuses on why formal institutional arrangements do not travel well from country to country, that is why *institutional transplants* often fail and inefficient institutions persist. The constraints imposed on institutional reform by the knowledge problem as well as by political and social resistance to reforms are key aspects emphasized by Eggertsson. By so doing, he introduces the concept of “social technologies”. Production technologies and social technologies are necessary complements for a country to grow and develop. In a second paper Claude Menard focuses on the many “hybrid” business forms for organizing production and distribution that can be found in market economies. Under the apparent heterogeneity of such hybrid forms as cooperatives, subcontracting, supply-chain systems, distribution networks, franchising, partnerships, alliances, etc. Menard shows that they share some basic characteristics qualifying them as specific “institutional structures for production”. He also emphasizes the central role they play. Beyond their relevance for economists wishing to understand the co-existence of alternative modes of governance, hybrid arrangements provide unique opportunities for theoretical investigation on the nature of inter-firm coordination.

Ian Kirkpatrick addresses another very relevant organizational issue: how are markets for social care services being organized in the United Kingdom and how are these rules for “contract based competitive provision” influencing performance? Kirkpatrick states that while these reforms have been pursued vigorously in the management of several public services, particularly in developed countries, there is still little evidence to support the claim that markets in the public sector always deliver improved efficiency and quality. This is particularly the case concerning the UK social care services for adult and young people examined by Kirkpatrick. Next, a paper by myself follows. It focuses on a singular institutional development that has recently taken place in Spain in order to emphasize that unorthodox organizational choices may produce favorable consequences when collectively adopted in singular circumstances, as such as those that took place in Spain in the mid 1970s when dictatorship was replaced. Although many institutional reforms in policy governance have been implemented since democratic transition, this paper focus only on the rules governing the taxing powers and other financial matters of the seventeen new regional parliaments and executives created after the 1978 Constitution. The arguments and

figures provided show that the overspending incentive and the political mobilization generated at this level of government by the asymmetrical and competitive model of federalism in existence have been key factors for the surprising path of growth and development registered in Spain since the 1980s.

Manuel Palma focuses on some organizational issues related to development and underdevelopment in Mexico. Particularly he argues that some basic political arrangements now framing Mexican politics create impediments to the coordination required to sustain and advance those successful economic reforms implemented since 1982. These arrangements generate high public policy transaction costs and a weak protection of the rule of law. Formal and informal institutional environments that do not provide for the adequate enforcement of political exchanges also generate high transaction costs. Politicians will have to design complex mechanisms to protect their rent allocation. Many political transactions with positive effects on development will not take place, and others will result in relatively inefficient public policies. Because all these factors play a key role for the allocate efficiency of markets, they undermine Mexican prospects for growth and development. Finally, Gonzalo Caballero focuses on how the Spanish and USA Congresses are organized. The main purpose of the paper is to unveil the so-called “black box” factors operating in each case. The role played by property rights, hierarchy, individual deputies, leadership, transactions costs, and committees are investigated in order to show that we already know very much about the industrial organization of congress and how the organizational solutions adopted affect those regulatory outcomes each country can provide for itself as well as many other aspects of policy-making.

## Notes

- <sup>1</sup> For further information about the antecedents see Scott (1984), Eggertsson (1990, chaps. 8-9), Williamson (1985a), (1985b), (1990), and Williamson and Winter (1991).
- <sup>2</sup> A list of participants and topics debated in these seminars can be seen at <<http://www.mpp-rdg.mpg.de/oekinst.html>>
- <sup>3</sup> Some very much cited contributions by Coase and North over those years were their Nobel lectures Coase (1992) and North (1994), as well as Coase (1974), (1982), and (1984), North, D.C. (1986), (1988), (1989), (1990), and Danzau and North (1994), as I will comment next.
- <sup>4</sup> See Libecap (1993, p. 32).
- <sup>5</sup> See Libecap (1989a), (1989b), Greiff (2005), Winiecki (1996) and Barthan (2000), (2001).
- <sup>6</sup> Eggertsson (1996, p. 16) explicitly refers to this issue concerning NIE when he states that this analytical perspective “also provides an opportunity for explaining the institutional arrangements than affect the relative power of workers and employers, and exploring how these power relationships emerged and how they are maintained... The framework does not suggest that all institutional change is explicitly designed to increase aggregate wealth as many critics seem to believe. Purposive institutional change reflects both the power and interests of those who control institutional change and the process for making decisions in the political sphere”.
- <sup>7</sup> Agassi (1960), (1975). See also Toboso (2001).
- <sup>8</sup> On multilevel institutional frameworks see Tsebelis (1990), and Williamson (1996c), (2000), (2003).
- <sup>9</sup> See for example Williamson (2003).
- <sup>10</sup> At <[www.isnie.org](http://www.isnie.org)> it can be read: “The New Institutional Economics (NIE) is an interdisciplinary enterprise combining economics, law, organization theory, political science, sociology and anthropology

to understand the institutions of social, political and commercial life. It borrows liberally from various social-science disciplines, but its primary language is economics...”

<sup>11</sup> See Williamson (2000).

<sup>12</sup> Among many others, Coase (1974, p. 181), (1982, p. 7) and (1992, p. 718) has recurrently emphasized these and other aspects. Menard (2001) deals also with key methodological issues of NIE theories.

<sup>13</sup> See for example, World Bank (2002), *Institutions for Markets*; World Bank (1997), *The State in a Changing World*; World Bank (1994), *Institutional Change and Public Sector in Transition Economies*.

<sup>14</sup> Several other examples could be mentioned for showing the increasing attention paid to these contributions. Schmid (2001) emphasizes that several scholars with an institutionally oriented economic approach have received the Nobel award.

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