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Institutions and Their Design

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THE PRINCIPAL AIM of this introduction is to sketch the contours of the existing literature as it touches upon theories of institutional design. It will situate the contributions of the present collection as well as map the domain of the larger series within which this collection is set.

The chapter starts by tracing continuities and discontinuities in the study of institutions, in the first instance, on a discipline-by-discipline basis. I avoid prematurely and preemptorily defining the term “institution,” preferring instead to let each discipline speak with its own voice. Inevitably, each discipline (and indeed subdiscipline) focuses on different institutions as paradigmatic and picks out different characteristics as their defining features. I propose to harness rather than straight-jacket this diversity. Once I have let all these disparate disciplines have their say in their own ways, all of them will then be consolidated into a few broader reflections upon the form and function of social institutions. As part of that, I identify a minimalist definition of “institutions” upon which most institutionalists, old and new and across a range of disciplines, can broadly agree.

That analysis provides a platform from which to address, in the final two sections, questions about the perfectability of social institutions. Key questions there concern the extent to which institutions acciden-

An earlier, very different paper served as background for the ANU conferences from which most other chapters of this book are drawn. I am grateful to Geoff Brennan for helping to develop, and to conference participants for helping us to clarify, those issues. I am also grateful to Paul Bourke for the opportunity to try out these ideas on the Australian Historical Association and for other comments and criticisms from David Austen-Smith, John Braithwaite, John Dryzek, Patrick Dunleavy, Patricia Harris, Barry Hindess, Claus Offe, Philip Pettit, Peter Self, Barry Weingast and, most particularly, from John Ferejohn and Diane Gibson.

tally emerge or automatically evolve, and the extent to which they are subject to intentional design and redesign. Insofar as intentional (re)design of some sort or another is a feasible aspiration in any sense at all, further questions arise about what sorts of principles, both normative and empirical, might properly be employed in those endeavors.

1.1 Institutionalisms, Old and New

Each of the several disciplines that collectively constitute the social sciences contained an older institutionalist tradition. In each case that tradition has recently been resurrected with some new twist. Just as the older institutionalism within each discipline had focused on some slightly different aspects of the phenomenon, seeing social institutions as solutions to the problems which each respective discipline deemed central, so too does the new institutionalism mean something rather different in each of these alternative disciplinary settings. Each of these perspectives has something to contribute to a more rounded view of the ways in which institutions shape social life. But the advantages that come from building toward the larger truth in this way can come only through the realization that the “new institutionalism” is not one thing but many.¹

1.1.1 New Institutionalism in History

Not so long ago, history was principally political history, the study of wars and kings and courtly intrigues. Of course it is also true that history is, and has always been, essentially a matter of storytelling; and a good story requires a good *dramatis personae*. Thus traditional political history has always been highly personalized and in it institutions are always inevitably personified: states by their princes, estates of the realm by their friends at court, and so on.

Although told through stories of striking personalities and individual daring, traditional histories were essentially stories of political institutions, their shaping and reshaping. Kings and courts, states constituted around them, and wars between them are institutional artifacts – the products of political organization. In that sense, history as a discipline has traditionally been highly institutional in its fundamental orientation.

Traditionally, though, it was the specifically political subset of social institutions that attracted most of the historian’s attention. The work-

¹In ways well captured in, e.g., Smith’s 1988 account.

ings of social and economic institutions were certainly also considered, of course, but basically just as they touched upon the political. That focus upon several institutions, but essentially just political institutions, constitutes what I shall here characterize as history's "old institutionalism."

Over the course of this century, the understanding of history as the study of kings and wars has fallen out of fashion. Political history has gradually given way to social history. In that shift – symbolized as much as precipitated by the *Annales* movement – history has increasingly come to be seen as the history of everyday life. And if what counts as central in history is the lived experience of the past, court history is largely irrelevant. Historically, courtly doings have impinged only on the margins of everyday existence – even, historically, when they resulted in war.

In recent years, the focus of history as a discipline has shifted once again. The everyday life of the ordinary person, we have come to appreciate, does not stand alone and utterly apart from the rest of the larger society. There has, accordingly, been a shift back to the study of larger social institutions. The focus of these new histories is not necessarily upon kings and courtly doings (or their contemporary equivalents: presidents and cabinets, legislatures and judges, financiers and media magnates). Certainly newer forms of historical inquiry do not focus on that to the exclusion of all else, in a way that older forms of historical inquiry might once have done.

The newer focus is, at one and the same time, both broader and narrower. The focus is both upon social institutions more broadly (like churches, the family, and the labor market) and upon organs of the state more narrowly (like the workings of social relief agencies, the Children's Bureau, or public works or public health agencies).² As a result of this reorientation, history is once again largely a story about the workings of social structures, albeit now with a new focus upon the actual impact of those structures on real people's ordinary lives.

The peculiarly historical contribution to institutionalism, old or new, lies in history's fixation upon the past. If in social scientific terms each discipline "owns" one particular variable, time is history's. Insofar as it has social scientific aspirations, history is just the study of the way in which the past shapes the present and the future. Or, in less Whiggish mode, we might say that history just amounts to the telling of stories

²For good samplers, see Evans et al. (1979) and Steinmo et al. (1992). For exemplary studies, see Theda Skocpol's *Protecting Soldiers and Mothers* (1992) or Karen Orren's *Belated Feudalism* (1991).

about the past which we internalize as our own and which, in the telling and retelling, shape us and our future actions.³

That the past exerts this sort of influence over us is the central claim of history as a discipline, and that is the peculiar emphasis it imparts to its various forms of institutionalism. Questions of why and how the past exerts that sort of sway are essentially left to other disciplines to resolve. Good historians naturally speculate upon the psychological or sociological or political dynamics at work. They will gesture toward the satisfaction that comes from fitting one's life into some large narrative structure, or to the historical construction of the *conscience collective*, or to organization as both the mobilization and ossification of bias. But gestures these typically remain.

Even when historians' attention is caught by the workings of social institutions, their interest is in the particular tale surrounding the particular institutions at the particular historical juncture. The peculiarly historical interest tends not to lie in what broader theory can be constructed around those and other cognate cases. Indeed, those of a peculiarly historical cast of mind often shy away from such larger generalizations, thinking that they necessarily do violence to the historical particularity surrounding each of the specific cases that together, in very stripped-down form, constitute the more scientific social scientist's "data."⁴

1.1.2 New Institutionalism in Sociology

From its beginnings, sociology too was essentially concerned with the study of social institutions. At the outset, this concern took the form of fixating rather unimaginatively upon a standard catalogue of institutions. Herbert Spencer's 1879 *Principles of Sociology*, for example, progresses through a tedious array of ceremonial institutions, political institutions, professional institutions, industrial institutions, and so on.

The ensuing classics of modern sociology imposed far richer theoretical overlays upon such pedestrian partitionings of the sociological problematique. But it is fair to say that all the masters of modern sociology – Pareto, Mosca, and Michels; Tönnies and Durkheim; Simmel

³That alternative formulation crucially differs in that it acknowledges the ways in which we read the past in light of the present. But centrality of "the past" remains: what gives these largely fictitious reconstructions the power of "history" is precisely the fact that they are fictions about the past.

⁴Contrast, for example, Tilton's (1990) study of the peculiar circumstances surrounding the foundation of the Swedish welfare state with Jackman's (1972) sixty-nation study of the emergence of welfare states in general; for a nice compromise between the two, see Esping-Anderson 1990.

and Weber; and, most especially, Marx – were all centrally concerned with the ways in which collective institutions subsume and subordinate the individual. All those classic studies – of “organic solidarity” as much as studies of “mechanical solidarity,” of identification theory as much as of organization theory, of “base” as much as of “superstructure” – essentially amount to stories about mechanisms for effecting social control over individual volition.⁵

Nowhere is this blending of concerns clearer than in the work of Talcott Parsons, on some accounts the greatest contemporary sociologist. His early work on *The Structure of Social Action* was officially concerned with the sources of voluntaristic individual action. But his collaborative *General Theory of Social Action* then formalized what in that earlier work were merely inchoate notions of “the social system” as a control mechanism, notions which achieved their fullest (and most rococco) elaboration in his later book of that same name.⁶

Inevitably there then came a reaction against what was seen as an overemphasis upon the way individuals’ volitions were shaped by collective social structures. Critics complained of “the oversocialized conception of man” in the dominant structural-functionalist sociology, entering pleas instead for “bringing man back in.”⁷ The ways in which these midcentury critics proposed doing that varied, from essentially phenomenological stories about the “social construction of reality” to social-psychologically inspired behavioralism and “action theory.”⁸

Whatever precise form the countervailing theories took, their basic thrust was to downgrade (but without ever totally denying) the importance of collective social structures and institutions in determining the actions and choices of individuals and groups within any given society. The emphasis within this midcentury sociological reaction against old institutionalism was upon the role of individual and collective choice as against social-structural determinism of all outcomes of social (or anyway sociological) consequence.

The “new institutionalism” within contemporary sociology is a reaction against that reaction, in turn. In part it amounts to little more than picking up older institutionalist-cum-structuralist themes and giving them a different normative spin. Old structuralist-institutionalists tended to be conservatives: observing structures, they tended simply to assume that they made some functional contribution to social stability;

⁵One of the best early renderings of that increasingly submerged theme in sociology is E. A. Ross’s (1901) little book on *Social Control*, originally published as a series of articles spread across the first three volumes of the *American Journal of Sociology*.

⁶Parsons 1937. Parsons and Shils 1951. Parsons 1952.

⁷Wrong 1961; Homans 1964.

⁸Berger and Luckman 1966. Manis and Meltzer 1967. Goffman 1970.

and they were inclined to celebrate that fact, thoroughly approving of the various ways in which the collective conscience got a grip on individuals.⁹ One group of new sociological institutionalists are basically radicals who, observing the same phenomenon (“structuration,” and domination of individual and group agency by structural determinants more generally), bemoan the ways in which such institutions exercise hidden power over helpless social agents, be they individuals or marginalized groups.¹⁰

Other new institutionalists within sociology, often no less radical in their politics, confine themselves to more narrowly analytic points. Individual action, they observe, is “embedded” within the context of collective organizations and institutions. Those actions are shaped, and their effects affected and deflected, by the institutional contexts in which they are set.¹¹ New sociological institutionalists of this stripe point, in particular, to the important role that intermediate organizations can and do play in shaping and reshaping both individual actions and collective outcomes emanating from them. The family is one obvious example very much at the center of many current controversies.¹² But theories of civil society, the density of institutional networks and mediating structures quite generally also figure largely in such accounts.¹³

Feminist accounts of the family and cognate social institutions combine these two approaches. Such mediating structures, they say, do so much mediating that certain institutionalized patterns of dominance and subordination disappear altogether from view. Feminists focus in particular upon the “public/private dichotomy,” which is so central to the self-conception of liberal societies; and they proceed to show the various ways in which collective, institutional relations of power and dominance reach into what were supposed to be purely privately ordered spheres. Thus, feminists say, opponents of social oppression need to examine the power relations embodied in the mediating structures of the putatively “private” sphere just as much as they do those embodied in more straightforwardly public institutions.¹⁴

⁹Contested though this familiar charge may be, as against American structural-functionists, it is frankly and forthrightly true of the most influential postwar German institutionalist, Arnold Gehlen (Berger and Kellner 1965).

¹⁰Giddens 1984. Lukes 1974. Dahrendorf’s classic 1958 essay “Out of Utopia” is a calmer precursor in broadly the same spirit.

¹¹Granovetter 1985; 1992.

¹²Berger and Berger 1983.

¹³Theoretical speculations (Hirst 1994; Cohen and Arato 1992) are powerfully confirmed by Putnam’s (1993) painstaking empirical analysis of the causes and consequences of civic traditions in modern Italy.

¹⁴Macintosh and Barrett 1982. See also Elshtain 1981, Pateman 1983/1989, and Okin 1989.

Were we assigning “key variables” to disciplines, the one owned by sociology might be said to be “the collective.”¹⁵ The old institutionalism within sociology focused upon ways in which collective entities – the family, the profession, the church, the school, the state – create and constitute institutions which shape individuals, in turn. The new institutionalism focuses, more modestly perhaps, upon ways in which being embedded in such collectivities alters individuals’ preferences and possibilities. But it is the hallmark of sociological institutionalism, whether old or new, to emphasize how individual behavior is shaped by (as well, perhaps, as shaping) the larger group setting.

1.1.3 New Institutionalism in Economics

Within economics, the dominant tradition has long centered around a neoclassical paradigm involving idealized free agents interacting in an idealized free market. Within that model, order and patterns emerge out of those interactions: they do not prefigure it. But there has long been, both within European public finance and American economics more generally, an “institutionalist” tradition predating and (especially in America) crystalizing explicitly into an opposition movement against that neoclassical orthodoxy.

The original notion of American institutional economics, as promulgated by John R. Commons and his followers, was to examine ways in which collective action can be institutionally embodied and in that form shape and constrain subsequent individual choice.¹⁶ The more positive and constructive side of the project was to study institutions and mechanisms – property law and the rules of the courts enforcing them, particular exchanges and the practices governing them, credit institutions and merchant banks, trade unions and trade associations, and so on – which create and control economic life. The more negative aim was to undermine the neoclassical orthodoxy by showing the many ways in which its idealized notions of “free markets” misrepresent the institutional reality of any actual economy, which is in fact dominated by actors (corporations, classes, central banks, or whatever) with precisely the sort of power to shape market outcomes (especially but not exclusively by altering relative prices of commodities and resources) that is assumed away in fictitiously idealized free markets.¹⁷

Still, the neoclassical paradigm remained much the dominant orthodoxy within twentieth-century economics. As that paradigm consoli-

¹⁵“Class” is, of course, just a special case of that more general formulation.

¹⁶Commons 1931, 1934.

¹⁷The papers collected in Samuels 1988, and especially the editor’s introduction, provide a good overview of these themes.

dated its hold on the profession, its ambitions ranged ever more widely. From the outside, it seemed to be a clear case of microeconomics run amok, staging a takeover bid not only for macroeconomics but also (in its “public choice” guise) exercising imperial ambitions over large areas of explicitly “nonmarket” (especially political) decision-making as well.¹⁸

The highest aspiration and continual quest, within this neoclassical program, was to provide “microfoundations” for macro-level phenomena in economics and elsewhere.¹⁹ The aim was to reduce all economic behavior – and, ultimately, all social behavior more generally²⁰ – to the interaction of individual preferences under conditions of scarcity (meaning just that not all of everyone’s preferences can simultaneously be completely satisfied). Smooth and more-or-less instantaneous response functions were simply assumed; “stickiness,” deriving from institutions or otherwise, was essentially just assumed away. Constrained maximization was the basic analytical device, equilibrium the preferred solution concept.

The attempted reduction never quite came off. But along the way the essentially anti-institutional program of neoclassical economics was powerfully sustained, both positively and negatively. Among the most crucial positive breakthroughs was Arrow and Hahn’s *General Competitive Analysis*, providing a proper microeconomic proof of the fundamental theorems of welfare economics (roughly speaking, that Adam Smith was right: the invisible hand really will, under idealized assumptions, work precisely the magic claimed for it).²¹ Negatively, too, Arrow contributed powerfully to the loss of faith in power of collective decisions to decide anything (that is the way his General Impossibility Theorem, showing that majority voting can lead us around in circles, was standardly – if not altogether correctly – interpreted²²) and to the loss

¹⁸To borrow a phrase from the title of the first issues of what later became *Public Choice*, the flagship journal of this movement.

¹⁹Weintraub 1979.

²⁰The work of Gary Becker (1976, 1981) best epitomizes this vaunting ambition.

²¹Arrow and Hahn 1971.

²²Arrow (1951), as interpreted particularly by, e.g., Riker (1980, 1983). That interpretation is variously flawed, however. All that Arrow’s proof actually shows is that cycling can happen, not that it necessarily will. Furthermore, that is true only on certain further assumptions which may not actually obtain (e.g., on the assumption that voters’ preferences are not substantially “single-peaked” across the community). Cycling is not in any case inevitable, because giving up on transitivity is only one among many possible responses (accepting someone’s preferences as “dictatorial” is another). Finally, note that the Arrow theorem applies as much to markets as to politics: the same results should apply equally in aggregating preferences there, too; and the main way we get equilibria in market economies is, in practice, precisely

of faith in the power of collectivities to organize to implement anything (which is the explicit thrust of his influential lectures on *The Limits of Organization*²³).

Latterly, however, there has been a resurgence of interest in institutional economics, reacting against the hyperindividualism of this microeconomic putsch. This resurgence is represented most notably, perhaps, in the work of Nobel laureate Douglass North. But because his work is in economic history, the power of the general points he makes – about the importance of institutional frameworks as background conditions for the emergence and operation of markets as we know them – might be blunted.²⁴ Perhaps a better representative for this purpose might be Oliver Williamson, whose transaction-cost economics generalizes Coase's observations about the nature of the firm into a larger theory, *The Economic Institutions of Capitalism*.²⁵

Whomever we choose as our representative, the basic point of this new institutionalism in economics is to show the various ways in which the actual functioning of the free markets of neoclassical economics requires and presupposes a fair bit of prior institutional structure. Most especially, institutions reduce transaction costs and in that way facilitate exchange. They promote trades, and hence trade.²⁶

Neoclassical economists value unfettered trade because it helps people to realize their desires and give effect to their choices, to the maximal extent possible within the limits imposed by scarce resources. Institutions facilitate trade. The way they do so, though, is precisely by constraining choice. If we could not sign a binding contract (or its social equivalent: stake our reputation on a binding promise) then we could never enter into any deferred-performance exchanges, in which one party has to act first, trusting the other to act later. Putting ourselves in a position to be sued, should we fail to keep our contract, is putting ourselves under a constraint – but it is one that we welcome, for absent

through imperfect (monopolistic or oligopolistic) competition creating concentrations of power that make some actors' preferences to a greater or lesser extent "dictatorial" in just this way. I am grateful to David Austen-Smith for forcefully impressing all these points upon me.

²³Arrow 1974. See similarly Wolf 1990.

²⁴North 1990. For a splendid case study – but also an example of the sort of thing that leads people to dismiss such work as consisting of purely historical curiosities – see his marvelous coauthored paper on the origins of the Law Merchant in the medieval trade fairs (Milgrom, North, and Weingast 1990).

²⁵Coase 1937. Williamson 1985. For a sociological perspective on the same themes, see Granovetter (1985, 1992).

²⁶Coleman (1990, esp. chap. 3) offers a compelling example of this, building up to a central clearing house and money economy from the increasing efficiency of mediated exchanges over barter ones.

such a system of constraints a raft of mutually beneficial exchanges could never take place.²⁷

In saying that institutions facilitate trade, it must also be recognized that institutions facilitate some trades more than (and in a world driven by relative prices, at the expense of) others. Institutions similarly facilitate certain trading channels and partnerships at the expense of other possible ones. In that way, institutions do indeed introduce and reinforce biases in favor of some interactions and interacting agents and against others. None of that should come as a surprise. After all, institutions are in essence just ossified past practices and the power imbalances and bargaining asymmetries embodied in them.²⁸

Emphasizing the importance of economic institutions thus amounts to emphasizing the importance of things past as determinants of present economic choices. That is something that the neoclassical paradigm, in its purest form, would have hoped to wash away.²⁹ Borrowing a phrase from Hume's precepts about causation more generally, the neoclassical paradigm in economics would have liked to be able to insist that there can be "no action at a distance" – here, at a temporal distance. It would have liked to be able to insist that complete descriptions of the present state of affairs, together with suitable covering-law style generalizations, are all we need to make reliable predictions about future states of affairs.

In a way, that is certainly true. Unless the past leaves a residue in the present, it is incapable of influencing either the present or the future through it.³⁰ But the past does leave such residues. Among those traces are the institutions created by past behavior and choices. Also among them is the impact of past choices and experiences in shaping our present preferences.³¹ In these and many other respects, what matters in our economic (and other) choices is not just where we sit at the moment but also how we got there. Most phenomena in social life manifest "path dependence" of just this sort. That influence of the past on the

²⁷The contract example is offered by Schelling (1960, p. 43) and elaborated by Hardin (1982b, pp. 260–62); the point is further generalized by Streeck (1992).

²⁸Knight 1992.

²⁹Except, perhaps, by reference to sunk costs in existing plant and lock-in to particular technologies at particular historical junctures (Arthur 1989). But for neoclassicists, while differential costs of technological retooling might help to explain the relatively greater competitiveness of some economies than others at any given moment, sunk costs are of course to be ignored in deciding what to do next. Their advice is always to look to the present and future, not to the past, in framing choices. By-gones are bygone forever.

³⁰Elster 1983, chap. 1.

³¹von Weizsäcker 1973; Stigler and Becker 1977.