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New Institutional Economics: A Critique of Fundamentals & Broad Strokes Towards an Alternative Theoretical Framework for the Analysis of Institutions

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Abstract

This article explicitly deals with and scrutinises what can be perceived to be the core analytical issues and methodological concepts of new institutional economics. New institutionalism seeks to explain not just the origins and evolution of institutions of capitalism, but more generally the scope of the theory is supposed to be universally applicable. Granted this, new institutionalists often interpret the historical emergence and evolution of institutions in abstract logical terms. This is because of the static, timeless, ahistorical and asocial nature of marginalism and neoclassical equilibrium analysis used by new institutionalists. Hence, an attempt is made to propose certain methodological and theoretical premises that can pave the way for the construction of an alternative, qualified theory of institutional arrangements. In this vein, the issues of social structure, social relations, power and conflict come to central stage.

Keywords: institutions, social structure, social interests, social power

JEL Codes: D01, D02, P16

1. Introduction

In recent years the concept of “institutions” has become central in scientific and political discourse. This reflects an increasing awareness of the role of institutions in the functioning of (market and non-market) economies and in economic development more generally. In light of today’s economic turbulence and financial meltdown, the “big-bang” transition programs in the former socialist countries and the various structural adjustment programs in developing countries, politicians, economists and businessmen (from neoliberals to “new” leftists), all converge to the fundamental idea that the “right” institutional framework constitute a *sine qua non* condition in order to enhance economic growth and promote development. For instance, the International Monetary Fund (IMF) puts great emphasis on reforming corporate governance and financial institutions as a response to today’s economic crisis. Accordingly, the poor economic performance of developing countries is explained in terms of the lack of a clearly defined and secure private property rights system. This is because, according to the mainstream idea, in the absence of an appropriate guarantee for the fruits of their sacrifices, people would not take the initiative to invest, whatever the policies regarding macroeconomic balances, trade and industrial regulations may be. It is further believed that all within this line of thinking, effective incentives have to be private and predominantly materialistic, and therefore that no form of property rights other than private property rights can provide adequate incentives for good performance.

This emphasis on institutions and (private) property rights raises the need for a scientific theorisation of the issues involved, while also bringing to the fore some fundamental questions with regard to the origin and nature of different institutions, and to their desirability or otherwise, thus also raising the question of institutional change. Within economics, new institutional economics, the trend in economics that deals with the origin and evolution of (mainly capitalist) institutions within the mainstream tradition, has become well established. Many of the catchphrases articulated within new institutional economics such as “institutions”, “organisations”, “transaction costs”, “property rights” and “contracts”, have become very common in orthodox economics discourse. This development is intellectually stimulating and interesting because it raises some fundamental issues with regard to the role and functioning of institutions.

In November 2009, Oliver Williamson was awarded the Nobel Price in economics (Note 1). This follows the award to Ronald Coase in 1991 and to Douglass North in 1993. Between them, Coase, Williamson and North, are the founders and most important representatives of new institutional economics. This third Nobel Price is symbolic of the continuing vitality of the new institutionalist research program within, and around the borders of, mainstream economics as well as the occasional idiosyncrasy of the Nobel awards.

After, discussing the core methodological and analytical framework, where the New Institutional Economics are placed, an attempt is made to sketch an alternative theoretical framework for the analysis of institutions and property rights. Specifically, the endevour is to propose certain methodological and theoretical premises that pave the way for the generation of a qualified theory of institutional arrangements. In this vein, the issues of social structure, social relations, power and conflict come to centre stage. The aforementioned social factors are considered to be a *sine qua non* condition of a comprehensive analysis of institutions and property rights.

2. New Institutional Economics: Definitions and Concepts

New institutional economics as a body of theory emerged in the 1970's and 1980's, although its roots lie further back in time. It seeks to incorporate a theory of institutions into economics by making institutions endogenous and explicable from within its theoretical apparatus. In this way new institutionalism seeks to fill a gap in mainstream (neoclassical) economic theorising, where institutions, even when implicitly present, play virtually no role as exemplified by the examples of welfare economics and the Walrasian general equilibrium model. The common denominator of all new institutionalists is that institutions matter for economic performance, that institutional structures exert an important influence on economic behaviour, and that the determinants of institutions can be analysed with the aid of economic theory. In particular, their aim is to explain what institutions are, how they emerge, what purposes they serve, how they evolve and how – if at all – they should be reformed.

New institutional economics is a research program which includes various theoretical trends such as transaction cost economics (Ronald Coase, Oliver Williamson), property rights theory (Ronald Coase, Armen Alchian, Harold Demsetz) (Note 2), new institutional economic history (Douglass North, Robert Thomas) and the economic analysis of law (Ronald Coase, Richard Posner) to name but a few. Other theoretical approaches close to new institutional economics and sometimes defined as being within this research program include public choice theory, constitutional economics, the theory of collective action and the principal–agent approach (Furubotn and Richter, 1998; Schotter, 1981; Richter, 2005; Menard and Shirley, 2008).

The term "new institutional economics" was coined by Williamson (1975) but its origins can be traced back to Coase's classic 1937 article on the "Nature of the Firm" (Note 3). In his seminal analysis of the firm, through the introduction of the concept of (but not the term) transaction costs which a few decades later became the foundation of new institutional economics, Coase attempted to answer the question "Why do firms exist?". Until then, within neoclassical theory, the firm was merely treated as a production function which transforms inputs into outputs, thus representing what came to be known as the "black box" of neoclassical theory – the firm.

For new institutionalism institutions are formed to reduce uncertainty in human exchange "by providing a structure to everyday life" (North, 1990, p. 3). As North (1990, pp. 3-4) puts it, "institutions are the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction … in the jargon of the economist, institutions define and limit the set of choices of individuals. Institutional constraints include both what individuals are prohibited from doing and sometimes, under what conditions some individuals are permitted to undertake certain activities", otherwise, "in the absence of constraints we exist in a Hobbesian jungle and civilization is impossible" (p. 203).

Moreover, according to North (1990), there is a clear demarcation between the "institutional environment" and "institutional arrangements", and between "formal rules" and "informal constraints". For North (1990, pp. 4-5), the institutional environment or framework, provides the "rules of the game" affecting and shaping behaviour, while institutional arrangements include the "players of the game" or organisations – what Williamson calls "governance structures". "What must be clearly differentiated," North (p. 4) says, "are the rules from the players". "If the institutions are the rules of the game, organisations and their entrepreneurs are the players (Note 4). Organisations are made up of groups of individuals bound together by some common purpose to achieve certain objectives" (North 1994, p. 361). Thus, for North the institutional framework represents the "constitutive rules" of the game where various organisations interact. Williamson (2000, pp. 595-600) appeals to this distinction and argues that transaction costs economics is predominantly concerned with institutional arrangements, or governance structures.

There are, however, some major stumbling blocks in trying to sustain such a clear–cut distinction between the institutional environment and organisations. For one thing, the institutional environment of organisations includes other organisations such as the state. On the other hand, organisations themselves are made up of rules. Organisations and institutions are interlinked or vested within one another. They are not entirely separable species. Hodgson (2006, pp. 8-13) has argued that treating organisations simply as individual actors is problematic to the extent that organisations are defined as actors. If, however, it simply represents an abstraction from the internal relationships and mechanisms within organisations, he considers the treatment of organisations as individual players a legitimate analytical exercise. This abstraction, according to Hodgson, is legitimised by North's "primary interest in economic systems" and "on interactions at the national and other higher levels" (p. 9).

Concerning the second demarcation, North (1994, p. 360) exemplifies that "formal rules" are "[property] rules, laws, constitutions" and "informal constraints" refer mainly to "norms of behavior, conventions, self – imposed codes of contact". This suggests that an alternative is to view the formal–informal distinction as similar to the distinction between explicit and tacit rules.

Hodgson (2006) has tried to clarify this distinction further through a comprehensive discussion of the different definitions and the problems involved in defining terms such as rules (formal and informal), institutions, organisations conventions, habits etc., and makes an attempt to give some tentative definitions himself. He defines institutions as "systems of established and embedded social rules that structure social interactions", and rules as "socially transmitted and customary normative injunctions or immanently normative dispositions, that in circumstance X do Y". Organisations, in turn, "are special institutions that involve a) criteria to establish their boundaries and to distinguish their members from nonmembers, b) principles of sovereignty who is in charge, and c) chains of command delineating responsibilities within an organisation." Formal institutions are generally meant as institutions that are explicit, written or legal, while by informal institutions we generally mean non-formal, non-legal or inexplicit.

3. New Institutional vs. Neoclassical Economics

In the first page of his 1975's book *Markets and Hierarchies*, Williamson argues that new institutional economics is based on the view "that received microtheory … operates at too high level of abstraction", that "the study of 'transactions'... is really a core matter", and that "what they [new institutionalists] are doing [is] complementary to, rather than a substitute for, conventional analysis" (Williamson, 1975, p.1).

It seems that one obvious idea delivered here is that neoclassical theory is too abstract and does not encompass the reality and efficacy of transaction costs. Traditional microeconomic theory does not consider the set of activities that normally precede, accompany and follow market transactions and the associated transaction costs. Within new institutional economics the concept of transaction costs has become the centre of Coase's and Williamson's analysis of the firm and is the basis of an approach to the theory of institutions and property rights linked mainly with the works of Alchian (1965), Demsetz (1967), Alchian and Demsetz (1973) and North (1981, 1990). Williamson (1985, p. 19) argues that neoclassical theory is similar to physics which studies a frictional world, with friction being the analogue to transaction costs. By excluding transaction costs neoclassical theory also excludes institutions from its theoretical corpus. On the other hand, the inclusion of transaction costs in the theory makes it capable of dealing with institutions and reduces its level of "abstraction" (Note 5).

However, as already indicated, new institutional economics does not attempt to overturn or replace neoclassical theory, but, rather, serves as "complementary to … conventional analysis" (Williamson, 1975, p. 1). This means that new institutional economics builds on, modifies and extends neoclassical theory to permit it to come to grips and deal with institutions heretofore beyond its scope. In this vein, new institutional economics adds institutions as a critical constraint and analyses the role of transaction costs in the emergence and development of institutions and property rights. In this direction, new institutionalists take a step away from neoclassical economics by modifying the instrumental rationality assumption of neoclassical theory through the adoption of Simon's (1961 [1947]) concept of bounded rationality and Williamson's (1975, 1985) concept of opportunism. This is how Williamson (1975, p. 7) delineates the principal differences between neoclassical theory and his approach: "I expressly introduce the notion of opportunism and am interested in the ways that opportunistic behavior is influenced by economic organisation and … I emphasize that it is not uncertainty or small numbers, individually and together, that occasion market failure but it is rather the *joining* of these factors with bounded rationality on the one hand and opportunism on the other that gives rise to exchange difficulties".

Bounded rationality, by which Simon (quoted in Williamson, 1985, p. 11) denotes that the "human behavior is *intendedly* rational but only *limitedly* so", signifies the fact that individuals are not omniscient and have real difficulties in processing information, that they have restricted ability to handle data and formulate plans. Hence, Williamson (1975, 1985) assumes individuals to be only bounded rational, while North (1995, p. 18) suggests that "the place to begin a theory of institutions … is with a modification of the instrumental rationality assumptions". Coase (1984, p. 231), on the other hand, regards the assumption of "a [perfectly] rational utility maximizer" as both "unnecessary and misleading". It should be noted, however, that bounded rationality does not replace the assumption of instrumental rationality, it only relaxes the heroic assumption of perfect information. This means that being confronted with limited calculatory power, costly provision of information and a complex and uncertain world, the individual is no longer capable of acquiring perfect information, but he/she still behaves in a rational manner maximising his/her utility.

Williamson (1985, p. 47) defines opportunism as "self–interest seeking with a guile". What sets opportunism apart from the standard economic assumption of self–interest seeking behavior is the notion of guile, which includes individuals' inclination for "lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse". The existence of such behaviour is important because, while bounded rationality prevents the writing of complete contracts, opportunism raises the transaction costs of negotiating and enforcing a contract even further.

Thus, Furubotn and Richter (1998, pp. 435-436) conclude that the new institutional economics is an amalgam of a critique of standard neoclassical economics based on the absence of transactions costs, and an apparent move towards greater realism through a move towards a more empirically relevant model. This is achieved primarily by mellowing the concept of a fully rational "economic man", acting with full knowledge and certainty, into a concept of a "boundedly rational" individual acting upon limited knowledge.

However, new institutional economics does not break fundamentally from neoclassical economics. To the contrary, new institutional economics is a research program which is developed within and around the dominant neoclassical paradigm. Although new institutionalists start by acknowledging the deficiency of neoclassical economics in recognising the effect of positive transaction costs and the role of institutions in economic development, they end up erecting a theory that tries to accommodate institutions within a neoclassical framework. This means that while new institutionalists feel uncomfortable with a theory that seems to ignore institutions, on the other hand it represents a neoclassical attempt to deal theoretically with the fact that institutions matter. Institutional arrangements in this view are the result of rational responses to changes in the underlying economic conditions on the basis of the efficiency criterion. Consequently, the framework is built on orthodox microeconomic theory using marginalist analysis, general equilibrium theory and the principles of methodological individualism, individual self–interested rationality and economic efficiency.

More specifically, according to North (1995, p. 19), the new institutionalist approach "begins with the scarcity and hence competition postulate, it views economics as a theory of choice subject to constraints, it employs price theory as an essential part of the analysis of institutions and it sees changes in relative prices as a major force inducing change in institutions" (Note 6). These are the basic ingredients of the marginalist choice–theoretic approach and the static equilibrium theory of price (Coase, 1988 [1937], p. 34).

Thus, new institutional economics retains the neoclassical principle of methodological individualism, always couching its explanations in terms of the goals, plans and actions of individuals, and proposes an instrumental view of the emergence and change of institutions, i.e. all institutions have been consciously created in order to reduce the transaction costs of economic exchange and production. The result is that "the foundation stones of the NIE [New Institutional Economics] are the same as those of neoclassical economics: methodological individualism and individual rational choice given a set of constraints" (Richter, 2005, p. 171). Similarly, "... [T]he exponents of modern institutional economics apply the analytical apparatus of neoclassical theory (and newer techniques) to explain the workings and evolution of institutional arrangements and thus to expand the scope and predictive power of microeconomics (Furubotn and Richter, 1998, p. 2).

Using the Lakatosian (1970) terminology of "hard core" and "protective belt" as the essential parts of research programs (Note 7), the new institutional economics retains the "hard core" of neoclassical economics i.e. maximising behaviour, market equilibrium, and stable preferences. On the other hand, there is a modification in the "protective belt" in the form of information and transaction costs making property rights indispensable for the analysis of economic organisations (Note 8).

In addition to the lack of a precise definition of the transaction cost concept, the operationalisation and measurement of the concept is also problematic. New institutionalists emphasise the necessity of operationalising transaction costs. Thus, Alchian and Demsetz (1972, p. 783) pinpoint that the concept of transaction costs has to be measured and expressed quantitatively; otherwise the theory becomes a merely tautological exercise. In similar vein, Williamson (1989, p. 229) talks of the need to articulate transaction costs "into a more formal language". Hence, much of the reliability of the theory is based on whether transaction costs are quantifiable in such a way that real economic actors can know how to economise upon them. If not, then the whole exercise can give rise to arbitrary explanations, which are susceptible to subjective bias (Milonakis and Fine, 2007, p. 51). The transaction cost concept is based on the assumption that rational individuals calculate the transacting costs of alternative contracts. Accordingly, the operationalisation (i.e. the quantification and measurement) of transaction costs becomes a *sine qua non* condition for the validation of the theory.

For instance, for North (1990, p. 27), the understanding of why institutions exist is closely related with to theory of the costs of transacting, "… which consists of the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements". In the transaction costs category the new institutionalists include information costs, negotiating costs and those of writing contracts, the costs of protecting property rights and those of enforcement rules and agreements from different contractual arrangements. One major difficulty refers to whether these costs can actually become quantifiable.

To sum up, new institutional economics is not a development away from neoclassical theory. Rather it is best viewed as a demonstration of the use of the neoclassical conceptual apparatus in explaining the emergence and evolution of institutions (Note 9). In this vein, new institutional economics aims to fill a vacuum in neoclassical theory without denouncing its theoretical basis, especially the model of (bounded) rational maximising individuals acting within given constraints (Furubotn and Richter, 1991, p. 4). Thus, the analysis of institutions, as well as the impact of institutions on the behaviour of economic actors are reduced to a cost–benefit calculation of (more or less) rationally acting individuals. Institutional arrangements, in this view, are deliberately chosen by individuals on the basis of efficiency criteria. Hence, the emergence and evolution of institutions is viewed as the result of rational responses to changes in the underlying economic conditions. It can thus be suggested that new institutional economics has grown mainly out of developments at the heart of modern orthodox theory itself. As Simon (1991, p. 27) remarks, "the new institutional economics is wholly compatible with and conservative of neoclassical theory".

4. Towards an Alternative Theoretical Framework

Built on the premises of marginalism, methodological individualism and micro–rationality, the new institutional theory provides an analytical framework that fails to incorporate in a comprehensive manner any reference to social structures and relations, power and conflict. As such, this theoretical framework does not sufficiently take into account the dynamic historical evolution removing in this way history from economic theorising. New institutional economics tries to establish universal laws based on human nature irrespective of place and time, and, as a result, portrays individuals as asocial self–interested creatures, as embodied in the 'homo economicus' postulate. Thus, the emergence and evolution of institutions, as well as the impact of institutions on the behaviour of economic actors, is causally associated with cost–benefit calculations of (more or less) rationally acting individuals. In this vein, any attempt to explain institutional formations suffers from the substantial problems that new institutional economics has inherited from the asocial and static equilibrium approach of neoclassical economics.

Granted these problems, an alternative theoretical framework for the analysis of the origins and development of institutions in general, and of property rights in particular, seems necessary. Such a framework should be built on different methodological and theoretical premises. In order to construct such a theoretical framework, the social should be taken as the point of departure in the form of social relations, structures, interests, power and conflict.

No attempt will be made here to provide a fully–fledged theory of institutions. Instead some broad strokes towards such a theory will be sketched out based on our critique of new institutional economics. Hence, certain methodological and theoretical premises that can pave the way for the construction of a qualified theory of institutional arrangements will be proposed. In this vein, the issues of social structure, social relations, power and conflict come to central stage. The aforementioned social factors are a *sine qua non* condition of a comprehensive analysis of institutions and property rights.

5. An Analytical Construction

5.1 Methodological Individualism and Social Structure

One basic methodological foundation of new institutional economics is the principle of methodological individualism, that is, the perception that the individual (and his/her choices) has analytical priority over social structure and other social processes. In this vein, all social phenomena (including the origin and evolution of institutions) their structure and their change, are explicable by recourse to individuals, their traits, goals, convictions and actions (Elster, 1982, p. 48).

In this conception, social structure has no objective existence, independently of the social consciousness and acts of individuals. Individuals (bodies, organisms, and their associated cognitive and behavioural capacities) are real, while society, social structures and collectivities are not real at all, but are simply considered as gathering of individuals. The basic methodological position of new institutional economics rests on the premise of the individual, from whose will and (more or less rational) choices emanates every kind of social process from the existence of institutions to structural change.

Such a perception, however, which reduces everything to the level of the individual, is over–simplistic since it reduces the complex problem of the interaction between social structures and individual actions to a one–way process. Individuals, however, are enabled in social relationships and only exist within and through social activity. They don't have an existence external to society. As Giddens (1984, p. 220) puts it: "The methodological individualists are wrong in so far as they claim that social categories can be reduced to descriptions in terms of individual predicates". The human individual, no matter how great, powerful or important he/she is, acts within a given historical and social context. Society at large exists over and above the level of individual, and provides the social setting in which individuals interact with one another to form relationships. Thus, a social structure represents the objectification of human relationships. In this context, a social system is considered to be more than the sum of its individual parts and as such by definition cannot be reduced to them (Giddens, 1979, 1984).

Moreover, a social structure constitutes the set of relations in which people participate, whether they wish to or not, because of the centrality of these relations to the production and reproduction of social life. These social relations can be acknowledged or unacknowledged by the individuals involved, but do not depend on the identity of the particular agents (individual traits and attitudes), and they appear as 'external' to any given human action, although not external to all the individuals involved. Social structure as a concept is used to capture the objectively identified properties exhibited by social entities and to specify the objectively identified positions amongst their component elements. "Objectively identified" refers to the idea that a structural property does not depend on the ideas or actions of any single individual Seen from this perspective, social structure is described as a set of empty places, the terrain in which social relations and practices in the form of actual activities of individuals fill the slots (Wright, 1979, p. 21).

Giddens (1979, pp. 64-66) suggests that we should further distinguish between social systems and structures, the former being conceived as involving "regularized relations of interdependence between individuals or groups, that typically can be best analysed as recurrent social practices. Social systems are systems of social interaction Systems, in this terminology, have structures, or, more accurately, have structural properties. Structures are necessarily (logically) properties of systems or collectivities, and are characterized by the 'absence of a subject'". Granted this, social structure represents "the binding of time and space in social systems".

Although structures condition individual behaviour, they should not be considered as simple constraints of the individual action, but rather as decisively framing that behaviour and action. As Giddens (1979. p. 70) puts it "every process is a production of something new, a fresh act; but at the same time all action exists in continuity with the pasts, which supplies the means of its initiation. *Structure thus is not to be conceptualized as a barrier to action, but as essentially involved in its production*".

In such a framework, social structure acquires analytical primacy over individual action since the latter should be considered in the context of social relations in which people participate in a given social structure. The fact that human beings act with aim and purpose does not mean that history represents an exclusive fulfillment of that will. Instead, historical change may come about behind the backs of human actors, often with unintended consequences. As Marx (1904 [1858], pp. 11-12) has argued "in the social production which men carry on they enter into definite relations, that are indispensable and independent of their will ... It is not the consciousness of men that determines their existence, but, on the contrary, their social existence determines their consciousness" (Note 10).

So, instead of viewing individuals as the driving force of social change, social structure and change shapes and moulds individual action. This fact tends to lend support to another popular idea that human beings are all victims of the blind forces of history, without any power to stem its inevitable tide. This fatalism, which is the opposite of the voluntaristic position adhered to by methodological individualists, is often associated with extreme forms of methodological holism which imply that individual behaviour is completely determined by the social structures (Note 11).

However, Marx does not eliminate the subjective factor, the conscious activity of human beings in shaping their own destiny, nor does he consider individuals merely as puppets of blind "historical forces" working behind their backs. As he puts it, "men make their own history, but they do not make it just as they please; they do not make it under circumstances chosen by themselves, but under circumstances directly encountered, given, and transmitted from the past" (Marx, 1972 [1852], p. 10). Following Marx, Engels (2008 [1886], p. 105) acknowledges the importance of conscious, creative human beings in the historical process: "Men make their own history, whatever its outcome may be, in that each person follows his own consciously desired end, and it is precisely the resultant of these many wills operating in different directions and of their manifold effects upon the outer world that constitutes history" (Note 12).

For the purposes at hand, in order to construct a consistent theoretical framework for the analysis of institutions and property rights one has to move beyond the one sided solution to the problem of how social structures and actions are related offered by methodological individualism, towards a more dialectical mode of analysis of this relationship. Such a conception does not exclude human actors as subjects of history, but neither are they entirely free agents, able to shape their destiny irrespective of the existing structural conditions. In this vein, concerning the totality of society, individuals enter into social relationships that are partly independent of, and partly depended on, their will. Human history is guided by dialectical relationships of social structures and individual action. Reducing this complex dialectical relationship into a one–way process, as new institutionalists have done, will result in a reductionist conception according to which all social change is considered the result of individual action.

5.2 Social Relations and Collectivities

In his influential critique of Williamson's use of transaction cost reasoning in explaining the emergence and development of the firm, Granovetter (1985, p. 487) points out that "actors do not behave or decide as atoms outside a social context, nor do they adhere slavishly to a script written for them by the particular intersection of social categories that they happen to occupy. Their attempts at purposive action are instead embedded in concrete, ongoing systems of social relations".

New institutional analysis overlooks the fundamental social relations involved in any institutional arrangement. The totality of social relations is reduced to the level of contractual exchange relationships among individuals governed by the universal law of the minimisation of transaction costs. Thus, social relations are reduced to exchange relations which are in turn reduced to the same underlying principle governing the actions of individuals, regardless of whether one is serf or feudal lord, capitalist or worker, primitive Indian or European trader. They all attempt to minimise transaction costs irrespective of their social position.

What is missing from such an approach is the fact that the individual is always part of a social whole and is moulded by the underlying social relations according to the social position the individual occupies. As Marx (1993 [1857], pp. 264-265) argues, "society does not consist of individuals, but expresses the sum of inter-relations, the relations within which these individuals stand … To be a slave, to be a citizen, are social characteristics, relations between human beings, A and B. Human being A as such, is not a slave. He is a slave in and through society". In the new institutionalist perspective, all social categories disappear and the individual can be taken for granted through the universal notion of the (bounded or otherwise) rationality. In other words, the new institutional approach does not take into account the structural or social relationships which represent the template of society. What lies behind new institutionalism, is the idea that the individual is in the final analysis the determining category, in the sense that the individual is not subject to a dominant type of social relations. But as Gramsci, quoted in Thomas (2009, p. 394), argues "the human being can only be conceived as a historically determined human being, who has developed and lives … in a determined social complex, or a totality of social relations".

Further, collectivities and collective action are either completely excluded from the corpus of new institutionalism or else are treated as accidental to the social process given that the objective structural characteristics of social relations are not made explicit. Collectivities are considered as mere aggregations of their individual parts. As Fine and Milonakis (2009, p. 156), however, observe, "aggregating over thousands of individual acts … does not change their character as individual action. Simple aggregation cannot transform individual action into collective action. The later implies coordinated action on the part of individual agents to achieve some common objective. For this the identification of a collective agent is necessary".

North's (1981, p. 61) definition of classes on the basis of "commonality of interests" is characteristic of this type of approach: "classes are far too large and varied a group to serve as a primary unit of action … The individualistic calculus of neoclassical economics is a better starting point. Aggregation indeed may be as large as a class – as when the members view themselves as having common interests". Hence, according to North, individuals form a class because they have some "common interests". But this is an oversimplification. For one thing, North does not explain the meaning of the term "common interests". The question is what actually constitutes this "commonality of interests" at the level of a class? Do agents form a class because they share some "common situation", because they share similar life situations, or because they share a particular form of income? Further, the interests of the members of a given class do not necessarily coincide. Members of the same class are often in economic competition with one another. And a turn of events which affects the interests of most members of a class, may accidentally have just the opposite effect on the interests of some other members.

Given the vagueness of the use of the concept, the result is a relative theoretical looseness. This is because such a determination of class does not depend on the causal–structural positions held by the actors which define the essential characteristics of social relations. But as Callinicos, quoted in Fine and Milonakis (2009, p. 156), puts it "agents have shared interests by virtue of the structural capacities they derive from their position in their relation of production … [and] they draw their powers in part from structures… which divide them into classes with conflicting interests". Thus, the understanding of social class simply as a function of the (unspecified) interests of class members represents an attempt to categorise individuals into transient subjective groups – a simple gathering of individuals – subject to the endless instances of empirically identifiable recurrent practices of social reality, rather than an endeavour to conceptualise the social class itself at the level of structural social reality.

In order to construct a theoretical formulation of the notion of class as an objective social category, one has to take into account the social structure that characterises each social formation. This is the case with Marx (1991 [1894]), whose conceptualisation of class takes shape at the level of productions relations of each social system (Note 13). In particular, the specific position that each "individual" occupies within the social relations of production constitutes the initial condition which determines his/her class integration. Most importantly, class is not a characteristic or attribute of individuals. Rather, individuals act within a system of class relations, and embody those relations in various (often imperfect, sometimes contradictory) ways.

On top of his concept of class, Marx (1904 [1858]) develops the idea of "class consciousness" which transforms a potentially unconscious class or what Marx calls "class in itself" into a conscious class or "class for itself". Thus, within the context of class theory, Marx perceives societies as consisting of a mosaic of social class relations, which do not all belong to the same type of social structure. Instead they constitute the specific historical result of each historical epoch.

All institutions involve social structural properties and as such an alternative theoretical framework must fully integrate the totality of social relations, including collectivities such as classes. Thus, we have to move away from the new institutionalist conceptions of social relations formed exclusively at the level of individual exchange, and where classes are considered as mere aggregations of individuals, towards a deeper analysis of the structural elements of the societal whole as an essential starting point for a coherent theory of institutions.

5.3 Harmonisation of Interests and Social Conflict

General speaking, new institutional economics conceives society as a network of voluntary contractual relations and analyses the economy in particular in terms of contractual agreements among atomised individuals. In particular, the emergence and evolution of institutions and property rights are elucidated on the grounds of the deliberate and voluntary personal decisions taken by individuals. Hence, institutional formation is explained in terms of voluntary contractual agreements based on the transaction costs minimisation principle.

In this vein, Coase (1998 [1937]) and Williamson (1985) analyse the origins of the capitalist firm as the result of mutual agreements between entrepreneurs and labourers aiming at minimising transaction costs. Similarly, Demsetz (1967) and Alchian and Demsetz (1973) argue that the emergence of private property is a result of a voluntary agreement between the members of the community. North and Thomas (1971, 1973) and Barzel (1997, ch. 3), on the other hand, explain the rise of serfdom in Western Europe and analyse the feudal relations between tenants and landlords respectively on the basis of voluntary individual contractual agreements. The common element in all these accounts is the perception of the establishment and evolution of institutional rules as the result of the common will and action of separate individuals. Under these theoretical givens, the underlying assumption is that society embodies a fundamental level of "harmony of interests" that always eventually leads to beneficial "mutual agreements" between the contracted parties leading to new institutional formations.

The idea of "harmony of interests" can be traced back to Smith's (1986 [1776]) work, and implies that if people understand their own individual interests correctly they will see that they are not incompatible with those of others. Particularly for capitalism, this idea implies that there is no structural divergence of interests between different classes, but, instead, there is a fundamental coincidence of interests. In other words, capitalist society produces no irreconcilable clashes of interest; the interests of capital and labour are intrinsically harmonious (Note 14).

Such a premise, however, is a violent (unreal) abstraction, since in society in general, and in the economy in particular, interests cannot in principle be conceived as homogeneous or identical, but rather should be conceptualised as conflictual and antagonistic either at the individual level or between social groups and classes. As Commons (1996 [1925], p. 372) puts it, "this entire idealism of harmony of interests … falls to the ground if we once recognize that social conflict has always been and always will be a fundamental fact in the progress of mankind … There has not been and never will be an automatic harmony of interests, because there always will be scarcity of essential resources and of privileged areas of land through increasing pressure of population. If harmony of interests is actually attained it can be accomplished only as we go along, from day to day, dealing with each conflict as it arises, and settling it the best we know how". Thus, for Commons the idealism of harmony of interests collapses in face of the fact that social conflict is an intrinsic attribute of historical evolution, conditioned principally by the tension between the scarcity of goods and land and the pressure of population. Yet, according to Commons (ibid, p. 373), this social conflict is at the bottom mainly an individual conflict, which is multiplied into the thousands, and arises wherever the scarcity of resources puts impediments on an individual's or a group's effort to satisfy his/her interests: "we have actually millions of individual conflicts at every point where scarcity of resources places its limits of opportunity upon the individual, or class".

Contrary to Commons, Marx (2001 [1847], p. 109) argues that social conflict is not vested primarily at the individual level, but is, at bottom, a structural class conflict, since "social relations are based on class antagonism. These relations are not relations between individual to individual, but of workman to capitalist, of farmer to landlord, etc. Wipe out these relations and you annihilate all society". Accordingly, for Marx, social conflict is not caused by the scarcity of goods and land and the pressure of population as Commons suggests, but arise from the way a society produces material goods, the control and use of the means of production, and the manner in which these are utilised (Note 15). The basic conflict concerns who performs the labour, and who obtains the benefits from this labour.

Apart from their individual differences, although essential, both Marx and Commons explicitly stress that social conflict is an intrinsic ingredient to any societal formation and lies at the core of the historical process. In this vein, social conflict is a pervasive phenomenon and one of the most important catalysts of social change. Hence, an alternative theoretical framework has to move beyond the underlying idea of "harmony of interests" according to which institutional formation is brought about through a process of repeated harmonious voluntary contractions between individuals. This suggests that the issue of social conflict is a *prima facie* ontological condition for a coherent analysis of the emergence and development of institutions and property rights.

5.4 Power and Power Relations

Once the issue of social conflict is incorporated into a theory of institutions, institutional evolution cannot be conceived as a voluntary contractual process based upon mutual agreements, but instead has to take into account the underlying power relations that are intrinsic in each societal formation. This is because any effort to address institutional emergence and change forces confrontation with questions of power, since the resolution of any conflict depends primarily on the relative power of the individuals, groups or classes involved.

In new institutional theory where social institutions emerge as a result of a transaction cost minimisation process at the individual level, the question of power and conflict simply does not arise. In such a context, all institutions are seen as the result of voluntary decisions taken by individuals which produce efficient results (Note 16). This is because the deductive method used by new institutional economics is based on the assumption of harmonious self–interest, ignoring the issue of power. As Bardhan (1989, p. 1393) points out, however, the question of efficiency improving institutional change cannot be separated from that of redistributive institutional change, and that this "inevitably confronts us with the question of somehow grappling with the elusive concept of 'power' and with the political processes that much of neoclassical institutional economics would abhor". In similar vein, Tobosso (1995, p. 77) argues that new institutional economics are elaborated using "voluntary conceptualisation" as the basic mode of explanation of institutional emergence, at the expense of power considerations. According to Tobosso "voluntariness is defined by the new institutionalists as the absence of power influences", since there is no exercise of power if parties voluntarily enter into a transaction.

In similar fashion, Brenner (1976, p. 35, n. 11) criticises North and Thomas' (1971, 1973) interpretation of the manor system as based essentially on a voluntary contractual arrangement whereby labour services were exchanged in return for the lord's protection (Note 17). Brenner argues that North and Thomas' view of an exchange between individuals with different endowments "only begs the fundamental question of class: how do we explain, in the first place, the distribution of land, of the instrument of force, and of military skill within the society". The tenant–lord relationship is actually described by Brenner as a relation encompassing power and coercion to the lord's advantage. For him, feudal relations are based on surplus–extraction by the lords from the peasants rather than on a contract based on mutual agreement: "there was no 'mutual agreement' between lord and serf … On the contrary, it is precisely the interrelated characteristics of arbitrary extractions by the lords from the peasants and control by landlords over peasant mobility that gave the medieval serf economy its special traits: surplus extraction through the direct application of force rather than equal exchange via contract, as North and Thomas would have it". Thus, for Brenner power and coercion form an essential part of his explanation of the feudal social relations (Note 18).

Before proceeding into an analysis of the significance of power relations in institutional formation, it is necessary to discuss briefly the meaning of the notion of power itself. Russel (2005 [1938], p. 4) notes that power represents a fundamental concept in social sciences similar to that of energy in physics. In general terms, the essence of power in economics is determined by the fact that society is the world of a series of unequal, asymmetrical relations among individuals, groups or classes, who take unequal positions in production and exchange (Note 19).

The notion of power is conceptualised differently by different writers. For some it is treated analytically in an individualistic fashion. A characteristic example is Max Weber (1954, p. 323) who defines power in terms of "the possibility of imposing one's will upon the behaviour of other person". An individualistic conception of power is also adopted by Commons (1968 [1924], ch. 3) who identifies "economic power" of individual over individual as his central notion of power (Note 20). This individualistic notion of power also flourishes in the game–theoretical approaches, describing situations involving interactions between two or more agents with conflicting goals and with the ability to influence each other. In such a context, power analysis is restricted exclusively to the level of the individual in a bargaining context (bargaining power), i.e. to the capacity of an agent to achieve his goals relative to somebody else. This notion is contained at the level of microtheory, where the notion of power concerns the economic agents' aspiration to maximise their individual utility function by subordinating other agents' behaviour and resources controlled by them.

However, even this form of power at the level of individual agents cannot be understood simply by considering their atomistic relations without reference to the wider social context in which they interact. The individualistic conception of power, whilst an important aspect for a theory of social institutions and property rights, is nevertheless too restrictive, since it is the asymmetrical distribution of power at the social level that lies behind the relations of power at an interpersonal level. Consequently, although an agent may have power (this form of power may imply direct physical power or greater income power or even power to influence an opinion) within an interaction situation or "game" (e.g. greater ability than others to select a preferred outcome or to realise his/her will over others within that social structural context), he or she may or may not have the power to alter the "type of game" the actors play, the rules and institutions and related conditions governing interactions or exchanges among the actors involved.

It therefore becomes apparent that one has to move beyond the "individualistic" conception of power to something more embracing. This calls for a systemic notion of power, referring to a socially structured capacity enabling actions by individuals, groups and classes by virtue of their location within the web of social relations. In this way, the analysis of power is not restricted exclusively to the level of the individual, but takes into account the way in which society is organised and expresses itself in relationships of domination and exploitation. Seen from this angle, each social formation (i.e. feudalism, capitalism etc.) comprises a level of systemic power and forms a certain nexus of power relations between classes, groups and individuals. In this perspective, social relations embody power relations expressed as a structure of domination and subordination that is never static but always subject to contestation and struggle.

Moreover, systemic power does not merely operate within structural settings but also organises and reproduces the settings themselves. Consequently, systemic power shapes the framework of social relations and influences (or modifies) property relations. In feudalism, for instance, given that landlords are the owners of the means of production and peasants actually work the means of production in order to reproduce themselves (Note 21), feudal lords obtain their own surplus through power and coercion (Note 22). On the other hand, the specific structure of capitalist social relations, which is mainly explained by the relationship between capitalists (who own the means of production) and workers (who own only their labour power but are otherwise separated from other means of production), give rise to capitalists' power over workers expressed chiefly by the exploitation of wage labour to yield surplus value appropriated in the form of profit.

Given these considerations the argument is straightforward. If power is an intrinsic fact of social life built in the very way in which production, the first act of social existence, is carried out, then the exercise of power should be part and parcel of the process of establishing institutions and property rights. As Bartlett (1989, pp. 153-54) puts it: “Rights are socially determined. They do not descend like manna from heaven; they are human creation. The creation, or alteration in the form, of rights (unlike the exercise of exchange rights in a market) is likely to create winners and uncompensated losers. Unless everyone agrees to the change in the form of rights, some persons must have the power to compel others to accept new rights against their will! Without that power and its exercise there can be no ‘emergence’ of new rights. It is simply a logical impossibility and an historical nonentity”.

History is replete with examples of the process whereby the form of institutions and property rights are altered through the exercise of power. The enclosure movement of the sixteenth and seventeenth centuries in the European, and especially English, landscape constitutes a prominent example. “Primitive accumulation” is the term that Marx (1990 [1867], chs. 26-32) uses in order to characterise this historical process which heralded the emergence of capitalist relations. For Marx, primitive accumulation is the historical process of separating the independent producer from the land, tools, materials and other inputs that constitute the objective means and conditions of production. Marx examines the forces which helped to propel the embryonic capitalist relations of production and reproduction. The role of power and force are critical for the creation of the new institutions of wage labour and capital, in other words the class relations of capitalism (Note 23). As Marx (1990 [1867], p. 916) puts it, “force is the midwife of every old society which is pregnant with a new one”.

The expansion of the territories of the United States during the middle years of the nineteenth century is a second example of the formation of private property rights through the exercise of power. Initially, Indians acquired their own land which in most cases was organised on a communal base. As western colonisation of America continued, the colonisers (white people) wanted to establish exclusive (private) and tradable land rights, which form an intrinsic part to their civilisation. Native Americans, however, perceived these incursions as clear violations of the communal tribal rights systems that defined their society. As Bartlett (1989, p. 153) colourfully highlights “the path to resolution was clear. Decide which system of rights will prevail via resort to force. A new system of rights ‘evolved’. Externalities were internalized. Hundreds of thousands of Native Americans died, and those remaining were either removed to or contained within specific reservations. Later trades of the rights so established may have been Pareto superior. The process of their ‘emergence’ clearly was not”.

The inference from these historical examples of the genesis of capitalist relations is that the formation of institutions and property rights cannot be considered apart from the intrinsic power relations which are vested in society. Thus, in an alternative theoretical framework the issues of power and power relations must become *sine qua non* conditions for a comprehensive analysis of institutional arrangements.

6. Conclusion

The endeavour was to sketch out some broad strokes towards the construction of an alternative theoretical framework to new institutional economics for the analysis of institutions and property rights. In this direction it has been pointed out that such a framework must abandon the ahistorical and asocial foundations of new institutional economics. Moreover, it was shown that the origins and evolution of institutional formations cannot be found within the individual. In this vein the micro–rationality, cost–benefit calculation scenario of the emergence and evolution of institutions and the conception of the economy as a sphere of “voluntary exchanges” is unwarranted.

In this light, the economy, including production and exchange, must be conceptualised within its proper social and historical context. This means that an alternative theory must fully and consciously incorporate the social and historical from the outset. This means that individuals do not act in a social vacuum, but in a context of historically specific social relations and structured social positions. In such a framework the issue of power relations and social conflict forms an internal part of the analysis. The social and the systemic are genuinely taken as the starting point in the form of social relations, structures, stratifications and classes involving power and conflict.

Thus, it is obvious that the analytical, methodological and philosophical premises of an alternative theory must be different from the preconceptions of new institutionalism. This leads directly to the tradition of political economy as the appropriate theoretical framework for the construction of a comprehensive analysis for institutions and property rights, which, in turn, ultimately leads to Karl Marx’s critique of political economy.

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Notes

Note 1. Alongside Elinor Ostrom, a political scientist.

Note 2. For a critique in Property Rights Theory see Milonakis and Meramveliotakis (2013).

Note 3. For a critique in Coase 1937's article see Meramveliotakis and Milonakis (2018).

Note 4. For a critique in North's conceptual demarcation between the "rules" and the "players" see Meramveliotakis and Milonakis (2010).

Note 5. In his second book, Williamson (1985, p. 16) concentrates on what he later on referred to as "transaction cost economics", which, according to him, comprises "part of new institutional economics".

Note 6. From the central behavioural postulate of individualistic rational maximisation, new institutional economics constructs an (ahistorical) framework centred on the importance of relative prices. These are the main economic incentives to which individuals respond, and it is this rational response to prices that gives the approach its predictive potential. As North (1990, p. 84) puts it "institutions change and fundamental changes in relative prices are the most important source of that change". It should be noted, however, that in addition to the role of relative prices, North (1981, 1990) recognises the importance of ideology, culture and norms as crucial factors in the explanation of institutions. This suggests a form of eclecticism and allows North to avoid an overreliance on the rationality postulate of the neoclassical school. For a critique of North's theory see Milonakis and Fine (2007).

Note 7. According to Lakatos (1970) a research program is an ensemble consisting of a hard core and a protective belt. The hard core is composed of the fundamental presuppositions of the program. It defines the program and its elements are treated as irrefutable by the program's practitioners. Hence, to participate in the program is to accept and be guided by the program's hard core.

Note 8. Eggertsson (1990, pp. 6-9), also applies Lacatos' terminology to distinguish between a neoclassical based "neo–institutional economics" based on optimising models, and the "new institutional economics" based on the idea of bounded rationality.

Note 9. For this reason, Fine and Milonakis (2009, ch. 5) describe new institutional economics as being part of the process of "economics imperialism", by extending the concepts of neoclassical economics beyond it's traditionally conceived "economic" spheres.

Note 10. Social phenomena and institutions in particular as the unintended consequences of human action can also be found in Menger's (1963 [1883]) organic approach and Hayek's (1973) idea of "spontaneous order" as well as in other evolutionalists. Unlike Marx, however, for whom individual action is determined by social structure, Menger and Hayek adhere to an extreme methodological individualistic position where institutions are the (unintended) result of individual action.

Note 11. One of the central themes in Giddens' works (1979, 1984) has been the opposition to one-sided solutions of the problem of how social structures and individuals actions are related, found in functionalism, structuralism as well as certain varieties of methodological individualism

Note 12. At other points, however, Marx seems to ascribe to an extreme form of holism. In the Preface to Volume I of Capital, Marx (1990 [1867], p. 92) argues that "… individuals are dealt with here only in so far as they are the personifications of economic categories, the bearers … of particular class–relations and interests". Generally, however, in Marx's work, the role of both agency and structure in social theory is allowed for, although structure does seem to take the upper hand in his analysis in Capital.

Note 13. It is worth noting that Marx's notion of the class division of society follows the tradition of classical political economy. Smith (1986 [1776]) for instance, defines three classes under capitalism. The capitalists, who gain profit as income, the workers, who gain wages as income and the landowners, who gain rent as income. Similarly, Ricardo (1992 [1817], p. 3) identifies three classes, namely, the proprietors of the land, the owner of the stock or capital for its cultivation and the labourers by whose industry is cultivated.

Note 14. The idea of "harmony of interests" was developed also by Carey (1868) whom Marx described as "the most banal and therefore the most successful representative of the vulgar-economic apologetic". Carey tries to demonstrate the presence in capitalist society of a complete harmony of real and genuine interests. The foundation of his theory of the "identity of interests" was built on the (very questionable) assumption that wages increased in accordance with the increase in labour productivity

Note 15. Marx views the structure of society in relation to its major classes, and the struggle between them as the primary engine of societal change. As he famously puts it, "The history of all hitherto existing societies is the history of class struggles. Freeman and slave, patrician and plebeian, lord and serf, guild-master and journeyman, in a word oppressor and oppressed, stood in constant opposition to one another, carried on an uninterrupted, now hidden, now open fight, a fight that each time ended, either in a revolutionary re-constitution of society at large, or in the common ruin of the contenting classes" (Marx and Engels, 2007 [1848], p. 9).

Note 16. For instance, Alchian and Demsetz (1972) wholly reject the possibility of power relations in markets. On the other hand, although Williamson (1985) readily admits possible exercises of power in the context of asymmetric information and opportunistic behaviour, he regards the notion of power as inherently problematic and hence, as we have seen, analyses the emergence and development of the capitalist firm on the grounds of Pareto efficient outcome of free voluntary exchanges. North (1981, 1990) represents an exception by incorporating the issue of power into his theory. However, as we have stressed in the previous chapter, the way that North treats the notion of power is problematic since he reduces it to an individualist level in a bargaining theoretical context.

Note 17. "The fortified castle and armored knights … having specialised skills in warfare, provided local security which could never be equaled by any group of peasants ill-armed with primitive weapons and lacking military skills" (North and Thomas, 1973, p. 19), while the lord and his knights, who specialised in protection and justice, depended on serfs for what they consumed. Hence, serfdom in Western Europe, North and Thomas (1971) maintain, was essentially a contractual agreement, a mutual arrangement between parties involved in governing a transaction. The specific contractual arrangement chosen was the one that minimised transaction costs.

Note 18. Responding to criticism North (1981, p. 130) has also admitted "… that the warrior class was analogous to the Mafia in extracting income from the peasantry".

Note 19. Despite the wider acceptance of the significance of the notion of power in social sciences, neoclassical Walrasian equilibrium economics does not take into account power effects. This is because, in perfectly competitive markets, competition is supposed to eliminate any power effect, since each individual can simply select to stop interacting with a person that tries to impose his/her will and choose another person for transacting. For neoclassical theory, deviations from the perfectly competitive state of the economic system (e.g. monopoly power) is the only case where the concept of power is introduced into economic analysis.

Note 20. This stems from the fact that Commons' treatment of power is reduced exclusively to the level of his fundamental unit of analysis, that of bargaining "transactions" between individuals.

Note 21. It should be acknowledged that this is a very schematic description of feudal property relations for the purposes in hand. Feudal relations are more complex, since for instance the peasants actually had a form of de facto possession of their plot of land which they could pass onto their heirs. This, however, does not affect our argument.

Note 22. Marx (1991 [1894]) argues that in pre–capitalist modes of production in general the extraction of surplus production was dependent on other than economic means.

Note 23. "The proletariat created by the breaking–up of the bands of feudal retainers and by the forcible expropriation of the people from the soil". (Marx, 1990 [1867], p. 896).