



RAUSP Management Journal

ISSN: 2531-0488

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Universidade de São Paulo

Brasil

M. Hodgson, Geoffrey  
Prospects for institutional research  
RAUSP Management Journal, vol. 54, no. 1, 2019, January-March  
Universidade de São Paulo  
Brasil

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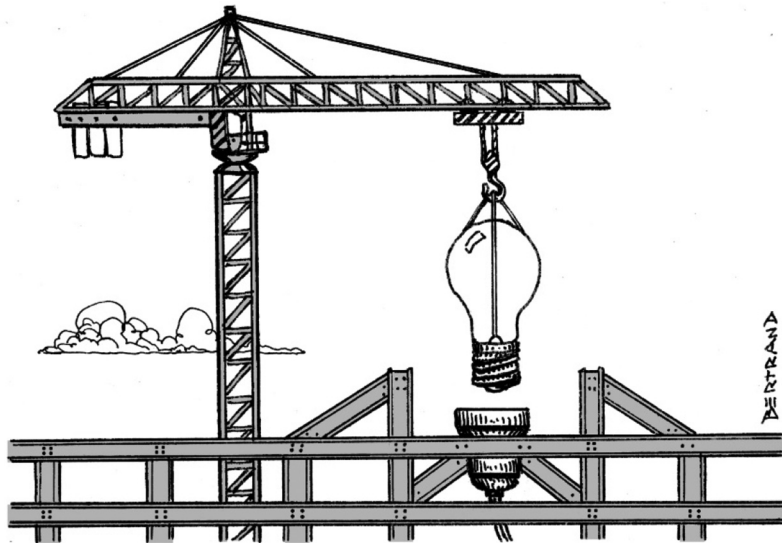
# Prospects for institutional research

Geoffrey M. Hodgson

*Loughborough University, Loughborough, UK*

112

Received 7 November 2018  
Accepted 8 November 2018



## 1. The need for institutional research

Everyone agrees that technology is important for economic development. But so too are organisations and other institutions. Douglass [North \(1971, p. 120\)](#) wrote:

The development of more efficient economic organisation is surely as important a part of the growth of the Western World as is the development of technology, and it is time it received equal attention. The few cases of which I am aware that have attempted to measure productivity change attributable to improving economic organisation certainly support this contention.

Here, North underlined the view that institutions (including organisations) were just as vital as technology in driving or enabling growth, but they had been unfortunately neglected. He



went on to make several major contributions to our understanding of the role of institutions in economic history and economic development. He stimulated many others to contribute in the same vein and he won the Nobel Prize in Economics for his efforts.

But despite North's achievements, there is still a prominent view in some quarters that economic growth and development are largely about physical inputs and technology. Yet the "social technology" [as [Nelson and Sampat \(2001\)](#) have put it] of institutions is equally vital. We need to build the interdisciplinary field of institutional research, to further contribute to our understanding of institutions and their role in socio-economic activity.

There is a useful precedent. Since the 1980s, there has been a remarkable global growth of research efforts in universities devoted to the new interdisciplinary field of innovation studies: it now sports its own institutes, academic positions, journals and degrees ([Martin, 2012](#)).

The massive success of innovation studies in attracting funding and researchers provides hope and inspiration for a new interdisciplinary field of institutional research. The case for the interdisciplinary study of institutions matches the case for the interdisciplinary study of technology. To understand economic institutions fully we need to draw from disciplines as diverse as sociology, politics, philosophy, law, history and psychology and economics itself.

The interdisciplinary field of institutional research can appeal to the fact that institutional innovation is just as important as technological innovation, and the social technology of institutions is just as important as the technology of materials. This essay considers some of the fundamental concepts and research problems that this embryonic field uses and encounters.

There are important debates about the definition of an institution, but a consensus is emerging that all institutions are systems of embedded social rules, even if that definition needs nuancing in some ways and some important controversies remain ([Ostrom, 1990](#); [Searle, 1995](#); [Hindriks and Guala, 2015](#); [Hodgson, 2006, 2015b, 2019](#); [Guala, 2016](#)). Such rules include laws, customs and established norms of behaviour. Consequently, systems of rules such as languages and codes of etiquette are institutions. Money is an institution because it entails shared rules concerning its value, function and exchangeability.

Organisations such as states, banks, firms and universities, are systems of rules, and hence also institutions. North has been widely interpreted as denying that organisations are institutions, but in correspondence he denied this ([Hodgson, 2006](#)). Organisations are special institutions because they entail rules of membership and sovereignty. They are a sub-area of institutional analysis in their own right ([Powell and DiMaggio, 1991](#)).

Institutional studies would rightly prioritise the study of those institutions that impact upon the economy. Other institutions, such as language, are studied elsewhere (in linguistics). Demonstrations of the positive or negative effects on institutions on economic activity are important to gain public support and funding for this field of research.

The basic definition of an institution as a system of established social rules raises a number of important questions that are central to institutional analysis. For instance, how are rules established in a community? Can some institutions arise spontaneously, or do some require some powerful authority? Why do people follow rules? Is rule-following a matter of habit or rational calculation? To what degree can rules be violated without endangering the survival of the institution? How do rules change? What happens when different rules prescribe conflicting or mutually incompatible actions? And so on.

Posing these questions raises issues of power, psychology, politics, law and much else. Hence such research must draw upon multiple disciplines. The fact that economic institutions are uppermost does not, in particular, mean that the rational utility-maximiser

of mainstream economics has priority over other psycho-philosophical depictions or explanations of individual behaviour. Rather than the dogmatic application of one particular approach, it is a question of what theories are most useful and enlightening in their explanations of the institutional phenomena under study.

Major contributions have already been made to the study of economic institutions by economists (both the original and new institutionalists), sociologists, political scientists, lawyers, philosophers and others. We need to combine these resources to develop institutional research.

It is important to acknowledge that institutional research has already made major progress, notably for example in the area of economic development. For instance, the literature on “legal origins” claims to show that countries adopting an Anglo-American style system of common law during and after colonialisation have experienced stronger economic growth (La Porta *et al.*, 1999, 2008). Daron Acemoglu *et al.* (2005) and his colleagues have proposed a different institutional theory. In North America, Australia and a few other places, the British colonisers made a deliberate attempt to set up legal and governmental institutions similar to those in their homeland. On the other hand, Britain and other European colonisers in Africa and South America, partly for reasons of disease in the tropical climate, were less inclined to build up European institutions. The colonisers focussed instead on the (often brutal) extraction of slaves and raw materials. According to Acemoglu *et al.* (2005), these different founding institutions largely explain subsequent divergences of economic performance. Although particular theories are controversial, there is now widespread recognition that institutions are major factors in helping to explain economic development.

The following sections explore different aspects of institutional research. The discussion of individual motivation in section two shows the importance of psychology and philosophy in understanding individual motivations, particularly to follow or break institutional rules. The discussion of property rights and transaction costs in section three illustrates some of the severe difficulties that may arise when definitions of key terms are contested or unclear. The final section wraps up the essay by drawing together some prominent issues for the future.

## 2. Institutions and individual motivation

Mainstream economists often assume that the individual acts like a rational calculator, maximising his or her own utility (or satisfaction). By contrast, many leading institutional economists – including Thorstein Veblen, John R. Commons, Ronald Coase, Douglass North and Oliver Williamson – have emphasised that the individual has limited information and is often unable to appraise the optimal position.

Important here is the idea of “bounded rationality” as developed by Herbert Simon (1957, 1979). He argued that individual rationality is “bounded” because of limited information, or limited capacity to analyse highly-complex situations or problems. Among others, North and Williamson both emphasised bounded rationality.

But in other respects there are big differences among institutional economists on how they understand individual motivation. Veblen (1899, 1914) emphasised habits. These are formed through repetition of action or thought. They are influenced by prior activity and have durable, self-sustaining qualities. A habit may exist even if it is not manifest in behaviour. Habits can be triggered by an appropriate stimulus or context. Habit is a *propensity* to behave in particular ways in a particular class of situations (Dewey, 1922; Camic, 1986; Ouellette and Wood, 1998; Wood *et al.*, 2002).

The Veblenian concept of habit points to a crucial psychological mechanism by which institutions may affect individuals. Insofar as individuals are constrained or motivated to follow particular institutional norms or rules, then they tend to strengthen habits that are consistent with this behaviour. They may then rationalise these outcomes in terms of preference or choice (Hodgson, 2010; Hodgson and Knudsen, 2004). According to this view, conscious choices are generally the outcome of habits, rather than the other way around.

Unlike other economists who take individual preferences as given, North (1981, 1990, 1994) delved increasingly into how ideologies and other cognitive factors can frame our thoughts and preferences, in specific institutional and cultural environments. He pointed to the limits of the standard rational-choice framework. He wrote:

History demonstrates that ideas, ideologies, myths, dogmas and prejudices matter; and an understanding of the way they evolve is necessary [...]. Belief structures get transformed into societal and economic structures by institutions (North, 1994, pp. 362-363).

The starting point of a *given* individual (with fixed and enduring tastes and preferences) is problematic. It could be a temporary explanatory simplification, but ultimately, we need to probe further. Individual choice requires a conceptual framework to make sense of the world. The reception of information by individuals requires cognitive norms and frames to process and make sense of that information. As the original institutionalists argued, the transmission of information from individual to individual is impossible without immersion in a common culture, in which the individual learns the meaning and value of the information that is communicated.

There are also problems with the idea that we can explain institutions *exclusively* in terms of individuals. Even the most basic institutions involve human interaction, typically using some kind of language. Language itself is an institution (Searle, 1995; Hodgson, 2006). The communication of information itself requires shared conventions, rules, routines and norms. Consequently, any project to explain the emergence of institutions on the basis of given individuals runs into difficulties, particularly with regard to the conceptualisation of the initial state from which institutions are supposed to emerge (Aoki, 2001).

While individual motivations and incentives are important, among institutional researchers there are differences in views on how they are understood or modelled, ranging to proponents of utility maximisation (where all behaviour explained in terms of attempts to increase utility or satisfaction) to those like Coase and North who adopted a more nuanced view of human nature (which addresses multiple factors, including moral motivation and possible altruism, as well as greed). To understand human motivation there is a strong case for bringing in insights from psychology, as institutionalists such as Veblen (1899, 1914) and North (1990) have argued. There is also a place for evolutionary ideas to help explain the nature of human motivation (Hodgson, 2013).

Relatedly, Knight (1992) criticised some prominent institutionalist literature for neglecting the importance of distributional and power considerations in the emergence and development of institutions. Importantly, Ostrom (1990) emphasised the role of culture and norms in establishing and moulding both perceptions and behavioural interactions. Scott (1995) stressed the cognitive dimensions of institutions.

The idea that institutions help constitute individual motivation and behaviour admits an enhanced concept of power into institutional analysis. Power is exercised not only by forceful coercion or constraint. For Lukes (1974) the overemphasis on the coercive aspect of power ignores the way that it is often exercised more subtly, particularly by customs and institutions. In this way, perceptions and preferences are altered.

Accordingly, to understand individual motivation and action more fully, institutional research should draw on these and other insights from multiple disciplines.

### 3. Property rights, law and transaction costs

The concept of property rights was stressed by original institutionalists such as Commons, as well as by more recent institutional researchers and those working on the “economics of property rights”. Property rights are seen as a vital component of the basic institutional structure of an economy with property ownership. But the concept of property rights has different definitions.

Some prominent economists have defined property rights in terms of control of an asset rather than moral or legal entitlement (Alchian, 1977; Barzel, 1994). Such definitions have been criticised for mistaking *de facto* possession for legal property (Heinsohn and Steiger, 2013; Hodgson, 2015a, 2015c, 2017). The upshot of the Alchian-Barzel definitions is that if a thief manages to keep stolen goods then he acquires a substantial property right to them, even if, on the contrary, legal or moral considerations would suggest that they remain the rightful property of their original owner. But it is misleading to describe the perceived ability to use or enjoy something as a “right”. Enjoyment or usage can occur without rights, and rights without usage or enjoyment. Possession is principally a relation between a person and a thing. It does not amount to legal ownership. Rights result from institutionalised rules involving assignments of benefit and duty (Honoré, 1961; Heinsohn and Steiger, 2013).

In contrast to Alchian and Barzel, Commons and Coase stressed that property must entail legal ownership, and hence, the legal system plays an important role in establishing deemed rights. Commons (1924, p. 87) saw the contractual exchange of property as involving a minimum of not two parties but three, where the third is the state or a “superior authority”. Similarly, Coase (1959, p. 25) saw property rights as determined:

[...] by the law of property [...]. One of the purposes of the legal system is to establish that clear delimitation of rights on the basis of which the transfer and recombination of rights can take place through the market.

By these definitions, property is a historically specific rather than a universal phenomenon (Honoré, 1961; Hodgson, 2015a, 2015c).

The role of law is still debated among institutional researchers. Some treat law principally as a cost or constraint for individuals, who are simply maximising their “economic” benefits (Barzel, 1989). Others point out to evidence that suggests that many people obey the law because they believe it is the right thing to do, not simply because they fear punishment (Tyler, 1990; Hodgson, 2015c). This raises the role of moral motivation, particularly when following accepted institutional rules (Smith, 1759; Sen, 1987; Hodgson, 2013; Smith, 2013).

Another important area of discussion is the role of law in constituting the modern firm and creating the possibility of corporate agency (Deakin *et al.*, 2017; Gindis, 2016; Hodgson, 2015a). A key question here is whether the corporation can be treated as an agent in itself, or must it be understood solely in terms of the human individuals that make up the organisation. Attention to legal aspects of the firm helps to answer questions concerning the nature and boundary of the firm. Hence it may help to restart progress in the theory of the firm, which has slowed down considerably since 1990.

The concept of transaction costs was originally highlighted by Coase (1937, 1960) and developed further by Williamson (1975, 1985) and others. Transaction costs have been regarded the costs of formulating, negotiating, monitoring and enforcing transactions. Coase’s (1937) path-breaking argument was that firms exist when the costs of an alternative

market-like arrangement are greater than the costs of operating a firm. Instead of organising production by numerous contracts at every stage of the process, the firm greatly reduces the number and complexity of transactions by placing workers in employment contracts under a single authority. That is why firms exist.

But there is an unresolved dispute between various definitions of *transaction cost*, which has important analytical consequences (Allen, 1991, 2015; Demsetz, 1968). Although the concept of transaction cost has been used by Williamson and others in extensive empirical work on contracts and organisational forms, the conceptual underpinnings are still debated. It is difficult to measure transaction costs directly. The many empirical attempts to test various forms of transaction cost analysis have brought mixed results (David and Han, 2004; Carter and Hodgson, 2006).

In clarifying and developing key concepts, institutional research needs to look at legal forms and to use insights from philosophy and elsewhere on how to refine and operationalise these categories.

#### 4. A future for institutional research

Institutions are the stuff of socio-economic life. Accordingly, the study of the role of institutions in the economy is likely to remain a central topic in the social sciences. In developed economies, the question of institutional design is of major importance. It impacts government policy and is vital in the development of business organisations. We also need to understand better the ways in which economic, political, legal and customary institutions interact and contribute to economic development.

If institutional research were to become more established as an interdisciplinary field of study, its agenda should address the following issues. First, there is the need to develop empirical databases to test institutional theories. Many of the successful recent pieces of research in institutional analysis have used empirical databases to test various propositions regarding the influence of different types of institution over economic performance. The development, refinement and use of empirical databases measuring institutional features will remain an important activity for institutional research.

Second, many of the disputes and inconclusive arguments within institutional research entail different definitions or understandings of key concepts, such as institution, property or transaction cost. More effort should be devoted to conceptual clarification – recruiting insights from philosophy and social theory – to establish more of a consensus and common understanding concerning these core concepts.

Third, institutional researchers need to build bridges between the disciplines involved. Many previous institutional researchers, including Veblen and North, emphasised the importance of delving into psychology, to obtain a deeper understanding of human motivation and of the reasons for following or breaking institutional rules. The importance of political science is widely recognised, and to a lesser extent sociology and anthropology. We should also follow Commons and others, in paying closer attention to the role of law in the economy. Last but not least, philosophy has also made a major recent contribution to our understanding of rules and institutions, and philosophy generally will remain important for institutional research.

Fourth, institutional researchers, from Veblen to North, understood the importance of developing an understanding of the mechanisms of institutional change. This remains an important unfinished task on the agenda. Institutional research may be able to make further progress by bringing in insights from evolutionary theory and from the study of complexity.

Fifth, the interaction between institutions and other factors, particularly technology, needs to be better understood. While some progress has been made in this area, there needs



to be more dialogue and cooperation between the study of technology and the study of institutions. We need to understand the similarities, differences and interactions between these two domains of evolution.

Finally, the policy implications of institutional analysis need to be developed, particularly by gaining further insights concerning the nature and role of key institutions such as markets, property rights, corporations and the state.

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**Corresponding author**

Geoffrey M. Hodgson can be contacted at: [geoff@vivara.co.uk](mailto:geoff@vivara.co.uk)

**Associate editor:** Flavio Hourneaux Junior