Institutional and Organizational Analysis: Concepts and Applications

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Book Abstract

Institutions and norms have increasingly been recognized as fundamental determinants of economic and political development. Institutions are rules that recognized authorities create and enforce. Norms are long-standing patterns of behavior, shared by a subset of people in a society or organization. These factors play a role in all organizations, including governments, firms, churches, universities, gangs, and even families. In this book we: (1) present a set of concepts, for example, institutions, norms, property rights, and transaction costs, used in Institutional and Organizational Analysis (IOA) that link institutions and norms to economic performance; (2) use the same set of concepts to better understand political organizations and performance; and (3) build a framework based on those concepts for understanding divergent developmental trajectories of nations around the world. In Parts I and II, we define the concepts needed to understand how economic activity is organized and how economic and political outcomes are shaped by institutions and norms. In Part III, we add the comparatively recent work on beliefs and leadership to better understand the fundamental question of why there has not been convergence in economic and political performance across countries.

Chapter 1

Institutions shape property rights, a broad term used to describe the rights, privileges, and other relationships associated with property. We distinguish between de jure property rights, the laws supported by the government and its associated power of coercion and de facto property rights, which are additionally defined by custom, norms and etiquette. Property is a social construct. We do not possess property in a social vacuum, so property rights define our ability to use different aspects of an asset within society. The costs of specifying and enforcing property rights – known as transaction costs – are fundamentally important for resource allocation. In a world of positive transaction costs, it is not a straightforward matter to rearrange property rights, so who has the rights will matter a great deal for resource allocation.

Chapter 2

Transaction costs are the costs of “transfer, capture, and protection” of property rights. This definition of transaction costs includes any costs associated with organizing human activity, regardless of whether the activity occurs in hierarchies or the price mechanism. Because transaction costs are never zero, the organization of economic activity and the distribution of property rights matter to economic efficiency. Transaction costs are a key determinant of organizational and contractual choice. Individual behavior in every organization is shaped by rules embedded in norms and institutions. Setting up rules incurs fixed transaction costs, and these rules and their enforcement in turn determine the marginal transaction costs of establishing and maintaining property rights within the organization and with other individuals.
and organizations. A richer set of assumptions about organizational behavior should necessarily focus on the incentives of individuals within organizations and the behavior those incentives elicit.

Chapter 3

Transaction costs shape the structure of contracts and organizations. The price mechanism and hierarchies can be thought of as endpoints on a spectrum of contractual choices and provide a theoretical justification for and examples of different intermediary forms, such as long-term contracts, sports leagues, joint ventures, and franchising. Several frameworks use the concepts of property rights and transaction costs to better understand the relative merits and costs of organizational and contractual choice, including classical and neoclassical; agency; governance; and new property-rights theories. Our mode of analysis also sheds light on why firms take on different ownership structures and what factors influence firms to go hybrid, that is, choose a nonstandard form of contracting.

Chapter 4

The concepts of property rights and transaction costs have explanatory value when applied in political contexts and specifically to the study of political organizations and relations. An important way to understand the demand for institutions by individuals and organizations involves the role and impact of interest groups on government policy. Every policy is potentially redistributive, so firms and individuals organize themselves to try to influence redistribution in their favor. The supply of institutions is the result of the interactions of a series of other actors that form the government and other organizations that participate in the process of policy making. Though this structure varies across countries, some basic units are present with variations in most countries.

Chapter 5

The supply of institutions in society plays as fundamental a role in their determination as the demand, which implicates the role of the legislature and the executive, typically the main actors in charge of creating and implementing legislation. Most countries – whether democratic, authoritarian, presidential, parliamentary, imperial, or other – have some variation of an executive and a legislative branch that concentrate most of the action in producing laws and policies. Examining variation in the structure of the legislature and the executive helps to explain differences in the nature, functioning, and impact of institutions seen in different countries.

Chapter 6

The administration and implementation of institutions suggests a unique role for the bureaucracy. Although the bureaucracy is not typically in the front line of the policy-making process and can appear to simply implement the decisions made by other actors, a country’s bureaucracy can have significant impacts on the content, quality, and effectiveness of the outcomes of laws. There is great variation in bureaucratic organization across the world, which can distort legislative intent and, in turn, is a measure of political effectiveness. The bureaucracy’s structure and process determine, for example, how large, effective, and accountable it is, as well as to whom it responds and to what extent it acts as a check on the three main powers.

Chapter 7
Although judiciaries vary greatly across countries and serve a wide array of functions, institutions can influence the structure and output of the judiciary in important and identifiable ways surrounding independence, accountability and reputation. Beyond the influence that institutions have on the structure of the judiciary and the incentives of judges, judiciaries themselves have an important impact on institutions. Different structures of the judiciary affect the nature and impact of the laws that ultimately prevail. A central interest here is the judiciary's role in providing judicial review of legislation passed by the other powers, as well as an important check on the use of power by these other actors.

Chapter 8

Although institutional change is highly contextual, a number of theories shed light on the comparative persistence of disparities in economic development around the world. A major determinant of the wealth divide is the complex process through which countries choose institutions. A change in core beliefs is at the heart of deep institutional change, which depends greatly on those in society with the power to change fundamental institutions. Our framework for deep institutional change consists of: (1) core beliefs and institutions begin in a state of equilibrium, consistent with each other as long as expectations are fulfilled; (2) core beliefs become malleable when expected or actual outcomes diverge sufficiently from expectations, creating a potential window of opportunity for leadership to change core beliefs; (3) the dominant network changes institutions based on their new core beliefs in a constitutional moment; and (4) core beliefs take root over time through subsequent institutional deepening as outcomes confirm expectations.

Chapter 9

Several historical examples show how utilizing the critical transitions framework helps to explain fundamental changes in economic and political developmental trajectories. Although all such transitions are contextual with their own nuances, transitions have common features: window of opportunity, leadership, change in beliefs, and a new dominant network followed by new institutions. The examples also display how a critical transition should not be assumed to be inherently positive or negative; such a characterization depends upon one viewing economic or political development as normatively preferable as compared to other outcomes. Furthermore, the transition to a new set of core beliefs might be highly detrimental to a nation's trajectory, given these same traditional notions of economic and political development. From the founding of the United States, to Argentina's notable decline during the twentieth century, to two recent examples of Latin American development, examples of critical transitions display the explanatory value of the framework applied to specific national contexts.