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Distribution Aspects in the Analysis of Public Sector Issues: NIE Contributions and Challenges.

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CONTENT:

- 1 Introduction.
- 2 On the evolution of the NIE approach since the 1970s.
- 3 Examples of NIE contributions in which distribution aspects are taken into account.
- 4 Efficiency and distribution: the two sides of each transaction in markets and governments.
- 5 Final remarks.
- 6 References.

ABSTRACT

Do members of ISNIE exclusively focus yet on transaction costs and efficiency when approaching public sector issues, thus disregarding distribution aspects, as it was the case over the 1970s and 1980s? Because the answer is not, the present article examines some analyses made by well-known new institutionalists in which distribution aspects are taken into account. Finally, the paper shows that efficiency and distribution are the two sides of all economic transactions people take through markets and governments. Distributional considerations are also present in those collective political decisions aimed at reforming current institutional structures. Institutional arrangements matter for both efficiency and distribution. As Eggertsson (1996, pag. 34) mentioned time ago, the paper concludes that there is nothing in the basic assumptions, criteria and methods often used by the NIE scholars that prevents them from also paying attention to distribution aspects as it is done by competing chools of thought in Economics and Political Science, including the Public Choice school.

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“Institutions are not necessarily or even usually created to be socially efficient, rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules.”

North (1990, pag. 16)

1. INTRODUCTION

In a recent article, Furubotn and Richter (2008, pag. 16) state that two main lines of research can now be found in the New Institutional Economics. One of them is associated with Williamson’s seminal contributions on industrial-business organisation issues. The other is associated with equally innovative contributions by North on how the institutional organisation of the polity and the economy evolves through time, varies from place to place, and always affect economic performance substantially. Furubotn and Richter also state that the explanatory and prescriptive analyses that are published in the Williamsonian tradition often rely upon the assumption that relevant economic agents care very much about transaction costs and efficiency. However, in the Northian tradition several authors have argued against the attempt to exclusively focus on efficiency issues when explaining what is going on in the polity, particularly as regards to those collective political decisions aimed at reforming one or another institutional framework.

The present paper addresses these issues. It deals with some contributions made by well-known NIE oriented authors, mainly in the so-called Northian or *political economy of institutions and decisions* branch of NIE. What follows has been conceived as an attempt to answer the following question: when NIE authors investigate the working of those formal and informal institutional structures that frame people’s decisions and transactions in the public sector, do they now systematically focus on transaction costs and efficiency considerations only, thus disregarding distribution aspects, as it was the case over the 1970s and 1980s?. As the answer is not, the present paper points to some examples of analyses made by self-labelled new institutionalists in which distribution aspects are considered. Distribution considerations are relevant for explanatory purposes even in those organisational situations in which transaction costs are very low and exchanges do in fact take place among participants, as the stylized example that will be examined here shows. Although all this was implicitly acknowledged by Coase (1960, 1978, and 1982) when he referred to how the initial assignment of rights greatly influences the starting point from which economic agents enter voluntary market exchanges, it has taken a long time for these ideas to get into the NIE paradigm.

As this article is basically about methodological and epistemological issues in economic research, a few more introductory comments on these issues may be helpful. When thinking about approaches in economic thought a straightforward question comes up: can we retain the *image* of economic realities transmitted through reports and analyses when we drastically alter any of the methodological-conceptual foundations upon which these theories or reports are built? Or let me say it differently: is it ideologically or politically neutral to pay more or less attention to the efficiency aspects as compared to the distributional ones? My answer is again: “of course not”. And this must be clear since the very beginning. This is why academic debates over approaches sometimes hide deeper ideological-political concerns or views.

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

All this is also well-acknowledged among new institutionalists as well as among other schools of economic thought. Coase (1974, pag. 181-2) (1982, pag. 16), (1992, pag. 716) made similar statements when commenting that statistical data are not natural facts but something elaborated and, because of that, theory laden in some way. Or that if figures are tortured enough always confess. If we go to competing schools of thought such as the public choice/constitutional political economy, Buchanan (1995, pag. 15) for example refers to the “*theoretical window*” through which the analyses elaborated in the realm of constitutional political economy are developed, also stressing that this theoretical perspectives or “*visions are, in fact, alternative windows on the world.... How can empirical evidence be made convincing when such evidence must, itself, be perceived from only one vantage point at time. The naiveté of modern empirical economists in this respect verges on absurdity*”.

It is also relevant to mention here that, as it is also well-known, many economic articles, books and reports are being elaborated by authors that do not even try to play the *scientific*

game of trying to find the most relevant explanation for the human affair under analysis. If economic transactions are always very much influenced by participants' expectations of future personal gains, then it seems straightforward that relevant participants will be interested in getting useful reports to advance their purposes in specific circumstances rather than just *true* reports. And so will their advisers, as well as similarly committed scholars. This applies to both scholars sympathetic to union leaders' bargaining strategies and scholars writing reports on alternative ways to reduce those transaction costs suffered by, for example, some cooperating firms wanting to coordinate their strategies against competitors. Many other examples could be mentioned.

Once all these influences upon our research activities and outcomes have been emphasized, it is time to address the main question posed above. For so doing, the article is organized as follows. Section 2 focuses on the evolution registered in the NIE analyses since the 1970s in order to show the enlargement of the approach that has taken place, particularly as regards to contributions focusing on public economic affairs. Section 3 offers some examples of NIE analyses in which distribution aspects are taken into account. Again, these analyses mainly come from what Alt and North in their Cambridge University Press book series refer to as the *Political Economy of Institutions and Decisions* branch of NIE. Section 4 stresses that efficiency considerations and distribution aspects are usually present in the economic transactions we all make in markets, governments and many other institutional settings. They are also present in collective choices aimed at reforming institutional arrangements. Section 5 concludes that there is nothing in the basic assumptions, criteria and methods mostly used by the NIE scholars that preclude them from systematically paying attention to both efficiency and distribution. Though researchers sympathetic with competing schools of thought in Economics and Political Science, including the Public Choice school, often focus on distribution they usually disregard how institutional settings affect transaction costs.

2. ON THE EVOLUTION OF THE NIE APPROACH SINCE THE 1970s

As is well-known, Ronald Coase is one of the NIE founders, and his classic works Coase, R. (1937) and Coase, R. (1960) are inevitable NIE references, together with the contributions of the property-rights theory in the sixties and seventies¹. However, it was through the articles and books published over the 1980s and 1990s that a more complete and coherent set of central core concepts, assumptions and criteria could in fact be gathered

¹ For further information about the antecedents see Scott, K. E. (1984), Eggertsson, T. (1990, chaps. 8-9, Williamson, O. E. (1985a), (1985b), (1990), and Williamson, O. E. and Winter, S.G. (1991).

from the many self-labelled NIE contributions of the time. It was particularly so since the international seminar series on the New Institutional Economics began in 1983 and these debates were published in the *Journal of Institutional and Theoretical Economics*.² In 1997, when the International Society for the New Institutional Economics (ISNIE) was launched, a long way had already been travelled by those hundreds of scholars who participated in the inaugural ISNIE meeting. Ronald Coase and Douglass North had already received the Nobel Prize award.³

Of course, those events already belong to the NIE-ISNIE history. Historic are also those initial contributions over the seventies and eighties in which transaction costs, property rights, bounded rationality and few more concepts were combined in an attempt to just solve some limitations of standard neoclassical reasoning. At those years it was also common to find papers in which scholars dedicated some of their time to explicitly remark that the antecedents of the new approach could more easily be found in the Neoclassical or Public Choice traditions⁴ than in the so-called old institutionalism and their modern successors.⁵ At those years many authors repeatedly expressed that their intention was to extend neoclassical microeconomic theory by relaxing some of its core assumptions in order to incorporate institutional factors and organizational aspects into their theories.⁶ In some cases, however, we can find self-labelled new institutionalist contributions of the time in which the emergence of informal institutions, such as some shared behavioural rules, were explained with an approach explicitly based on a psychologistic methodological individualism (plus the standard rational choice assumptions) mode of analysis characteristic of the

² A list of participants and topics debated in these seminars can be seen at <http://www.mpp-rdg.mpg.de/oekinst.html>

³ Some very much cited contributions over those years by Coase and North were their Nobel lectures Coase, R. H. (1992) and North, D.C. (1994), as well as Coase R. H. (1974), (1982), and (1984), North, D.C. (1986), (1988), (1989), (1990), and Danzau, T.D. and North, D.C. (1994).

⁴ While Furubotn, E. [1984, p. 3] refers to J. M. Buchanan and the public choice literature as something totally compatible to what new institutional economics should be when applied to constitutional choices, in his editorial preface of 1989 [Furubotn, E. 1989, p. 3] he explicitly rejects de Pareto efficiency criterion that J. M. Buchanan uses in dealing with constitutional reform. At those years, referring to his own version of the new institutional economics, North, D. C. [1990, p. 140] explicitly told against the public choice approach and the tools of the game theory, while in North, D. C. [1986, p. 235] he ambiguously stated: "The new institutional economics that I have briefly described in the foregoing section builds on the literature of transaction costs, property rights and public choice, and it requires integration of this three bodies of literature".

⁵ As it is surely remembered how sometimes this demarcation was accompanied with comments about OIE such as those by Coase, R.H. [1984, p. 230]: "American institutionalism is a dreary subject. (...) All it had was a stance of hostility to the standard economic theory. It certainly led to nothing. G. Gafen in the discussion suggested that the modern successor to the American Institutionalists was Galbraith and perhaps this is comment enough. (...) Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory, or a fire".

⁶ Statements in this sense over the 1980s may be found in Coase, R. H. (1984), Langlois, R. N. (1986a), Hutchison, T. W. (1984), and Williamson, O. E. (1984b), (1985a). O. E. Williamson sometimes makes references to J. R. Commons as in Williamson, O. E. (1985a), p. 187 or Williamson O. E. (1990), p. 63

traditional neoclassical contributions and, because of that, nor even fitting well in the above mentioned attempts to relax Neoclassical core assumptions.⁷ Many debates on methodological issues took place, however, at those years.⁸

It was also during the mid 1990s that Furubotn, E. [1993, p. 8] expressed what seemed to be a shared preoccupation of the time by many new institutionalists. He wrote: *"If it was thought previously that the work of the new institutional economics could be accomplished simply by extending neoclassical theory, there is reason today to believe that something more is required. (...) Some insights yielded by neoclassical analysis will continue to be valuable, but theoretical movement seems likely to be in the direction of a more flexible and comprehensive model of political economy"*. Since the mid 1990s till now, and particularly since the launching of the ISNIE in 1997, it is evident to me that a significant evolution has taken place in the NIE ideas and approaches in general. As North (2005a), Menard (2004), Menard and Shirley (2005), Eggertsson (2005), Toboso and Arias (2006a) and others make it easy to check, most analyses are now built on a much more comprehensive approach, particularly in the "political economy/public sector" branch of NIE. In current NIE contributions, authors systematically take into account the relevant sets of legal rules and social norms, as well as many other organizational details, influencing the human economic transactions under analysis. The strict reductionist rules of methodological individualism for building explanatory analyses are now followed only exceptionally as the rules of institutional individualism (a mode of explanation firstly depicted by Joseph Agassi⁹) are being widely used either explicitly or implicitly. This means that those relevant formal and informal institutional aspects affecting the transaction under investigation are usually taken into account as explanatory variables. This is also the case when the research task consists of explaining those changes in formal institutions that we see every where. Organizational

⁷This is the case, for example, of the image contained in those contributions resulting from the original Axelrod (1984), and (1986). that dealt with the emergence of the "to cooperate if others do" behavioral rule in which complete information, reputation effects, small number of participants and continuously repeated game interactions were assumed. Under these assumptions it seems rational for individuals, those contributions said, to adopt this rule of behavior instead of being calculating on every occasion whether or not to cheat in their transactions with other members of the small community. The free-rider problem gets eliminated in these stylized situations even without referring to transaction costs. Obviously, this image of the emergence of informal institutions hardly fitted in the t of individuals implicated.

⁸ On these debates Furubotn, E. [1984, p. 3] identifies the methodological foundations of the new institutional economics with the "traditional foundation stones of neoclassical theory-viz., methodological individualism and the self-interest principle". Williamson, O. E. [1984b, p. 197] in the same volume of JITE states however: "bounded rationality is the cognitive assumption on which transaction cost economics relies". Instead of helping, Eggertsson, T. [1990, p. 10] made things more complicated at those years with his criticised differentiation between "neo" and "new" institutional economics, as he himself has acknowledged to me recently.

⁹ Agassi (1960), (1975). See also Toboso (2001) and (2008).

reforms cannot appropriately be explained through non-institutional models as institutional arrangements, particularly the formal ones, are nested realities. There are always rules for reforming other rules. Some of them are written, others not. In many cases the informal ones are the most effective.¹⁰ Of course, most self-labelled new institutionalists still concentrate on revealing how institutional arrangements in one arena or another affect transaction costs and the total output reached by participants. Suggested reforms for downsizing transaction costs usually follow these analyses.

None of these ideas are particularly new. They were already debated during the eighties and nineties as the papers from the seminar series on the NIE that were published in the JITE show. In fact, it was in the nineties that the NIE research program acquired its current distinguishing characteristics. Some articles and books by D. C. North during those years can help us to further explain the characteristics of the NIE approach and also reveal how it already departed from the neoclassical perspective at those years.

In North (1988, 1990, 1991a, 1991b, 1993, 1995), for example, the *efficiency view* that characterized some of North's previous works was abandoned. Efficient changes are sometimes promoted and sometimes blocked in the political arena. Sometimes they are blocked for centuries, as the case of the medieval manor institution shows. In North's own words at those years: "Institutions are not necessarily or even usually created to be socially efficient, rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules." (North 1990, p. 16). He also abandoned his previous purpose of explaining all institutional changes in terms of self-interested human actions responding to changes in prices, technologies and natural conditions alone. Bounded rationality, as a behavioural assumption, entered North's analyses as well as many others.¹¹ Furthermore, it is through these publications that preliminary insights were provided on the role mental models and ideologies can play. His concern with cultural inertia and path-dependence should not surprise to anyone given that north is an economic historian.

Although capital accumulation and technological progress are relevant factors, the sources of contrasting economic performance between societies, he wrote, lie within the institutional structures that define incentives for saving, investment, production and trade and that also influence production and transaction costs. Because in standard neoclassical analyses most, if not all, institutional factors are removed and zero transaction costs are

¹⁰ On multilevel institutional frameworks see Tsebelis (1990), and Williamson, O. (1996c), (2000), (2003).

¹¹ See for example Williamson, O. (2003).

usually assumed, these analyses are of little help to North for explaining growth and development. Although North's analyses at that time were no doubt of an institutionalist kind, individual action remained essential for his explanations. Of course, individuals can act independently or they can coordinate their strategies and efforts through organizations. People in organizations always try to profit from the existing institutional environment, but they also attempt to modify the given institutional structure in order to achieve a more favourable one.

Although this is not the place to carry out a survey, what seems evident is that more and more relevant insights are being provided as the approach is being made wider and wider, as indicated in the ISNIE website.¹² Recently, Williamson (2003) has stressed that, in contrast to the neoclassical resource allocation approach in economics, what NIE represents is a move from the lenses of choice under physical, monetary and technological constraints to the lenses of contract and organization for systematically analyzing people economic transactions and agreements of all kinds. North (2005, p. 21) has also stated that “in contrast to standard (neoclassical) theory that draws its inspiration from physics, modelling the process of change must derive its inspiration from evolutionary biology. But in contrast to Darwinian theory in which the selection mechanisms are not informed by beliefs about the eventual consequences, human evolution is guided by the perceptions of the players in which choices -decisions- are made... in pursuit of their goals”.

Transaction costs, credible commitments, modes of governance, persuasive abilities, social norms, ideological values, decisive perceptions, gained control, enforcement mechanism, assets specificity, human assets, social capital, asymmetric information, strategic behaviour, bounded rationality, opportunism, adverse selection, moral hazard, contractual safeguards, surrounding uncertainty, monitoring costs, incentives to collude, hierarchical structures, and even bargaining strength, etc are now analytical conceptualizations much used when considered relevant for the research task at hand, even if some concepts abound more in some research areas than in others.¹³

If economic theories and reports must be relevant and instructive from the point of view of practitioners in firms, markets, governments, etc., they cannot be all built on an identical ex ante methodological jacket. Accounting for relevant particularities requires, of course, a

¹² At <www.isnie.org> it can be read: “The New Institutional Economics (NIE) is an interdisciplinary enterprise combining economics, law, organization theory, political science, sociology and anthropology to understand the institutions of social, political and commercial life. It borrows liberally from various social-science disciplines, but its primary language is economics...”

¹³ See Williamson (2000).

methodologically consistent approach or research program formed by a set of basic *hard core* conceptualizations, principles, and criteria. However, it also requires a varied and wide set of protective *belt* concepts to choose from depending on the situation under investigation.¹⁴

These central core NIE conceptualizations and criteria are now being also much used in research areas in which fifteen years ago they were just marginal. New institutionally oriented journals have been launched, and an increasing number of books and articles are published each year as on-line search engines show, particularly in the English language. In the realm of development economics, for example, Barhan (2004) has recently written: “Earlier preoccupations with the forces of capital accumulation or technological progress have been widely replaced by a belief that the institutional framework of an economy is crucial for an understanding of the process of development or lack of it”. Several Annual Reports by the World Bank have also focused on the importance for economic development of general institutional arrangements.¹⁵ And even W. Oates (2005), in a recent article entitled “Toward a Second Generation Theory of Fiscal Federalism”, refers to the lessons that can be obtained from NIE contributions.¹⁶ Hall and Soskice (2001)’s much cited book is labelled: *The Varieties of Capitalism. The institutional foundations of Comparative Advantages*.

3. SOME EXAMPLES OF NIE CONTRIBUTIONS IN WHICH DISTRIBUTION ASPECTS ARE TAKEN INTO ACCOUNT.

As mentioned earlier, more and more attention is also paid to distributional issues among the new institutionalists. Of course, institutional arrangements do greatly determine transaction costs as well as the total output achieved by people in a country or region. But these arrangements also affect, together with some other factors, the share of that output each participant obtains. If team action is considered, now it is also evident for some new institutionalists that arrangements used for organizing team action also influence the share in the efforts and costs needed to accomplish the common purpose. As several existing alternatives for reducing production and transaction costs will expectedly produce different distributional impacts on the affected participants, proposals for organizational reform are

¹⁴ Among many others, Coase (1974, p. 181), (1982, p. 7) and (1992, p. 718) has recurrently emphasized these and other aspects. Menard (2001) deals also with key methodological issues of NIE theories.

¹⁵ See for example, World Bank (2002), *Institutions for Markets*; World Bank (1997), *The State in a Changing World*; World Bank (1994), *Institutional Change and Public Sector in Transition Economies*.

¹⁶ Several other examples could be mentioned for showing the increasing attention paid to these contributions. Schmid A. (2001) emphasizes that several scholars with an institutionally oriented economic approach have received the Nobel award..

always a source of some dispute. In the polity this often causes conflict ending not in a general agreement but in a final vote with winners and losers, as Libecap, G. (1993, p. 32) emphasized time ago.

Current NIE conceptualizations and methods have been enriched so much over the last years that they allow now for analyzing situations such as those in which, for example, some groups of people may oppose to a specific market institutional reform even if there is a generalized perception that total transaction costs could be reduced as a result.¹⁷ In a similar sense, Horn, M.J. (1995, p. 16) states that due to the fact that “enacting legislators’ commitments, as well as the benefits provided to their constituents, are uncertain when subsequent legislatures come, they may have an incentive to protect those benefits by even attempting to implement inefficient institutional arrangements that increase the transaction costs of reversing those policies”.

Although North’s research efforts usually concentrate in evaluating the degree of efficiency characterizing alternative institutional settings and explaining why the total output grew much more in some countries than in others, he has sometimes paid an explicit attention to distributive issues, to the bargaining strength of participants and to non-voluntary transactions. He is the first author to be mentioned here as an example.

In North (2005:112), for example, he points out the “*violent struggle among competing groups for control of the polity and economy*” that took place in all new Latin American republics created after the defeat of Spanish armies and the independence movements. Even if many adapted a version of the United States Constitution as a model for independence, the consequences were radically different, he says, because of the colonial heritage they suffered from. The entire pattern of settlement, trade, and development was geared to the extraction of precious metals for the Spanish Crown. Through an authoritarian system not based on self-government., the Crown, North says, granted exclusive monopoly privileges to selected merchants, and trade was confined to a small number of ports in the whole of South America. The evident and well documented purpose was to facilitate the extraction and sending of precious metals to Spain, not to promote the development of people living there.

Without a heritage of democratic self-government with well-defined and enforced political and market rules, and a legitimated distribution of property and economic assets,

¹⁷ See Libecap (1989a), (1989b), Greif (2005), Winiecky (1996) and Barthan (2000), (2001).

independence disintegrated in a violent battle between groups for capturing the polity for controlling economic transactions. Those groups that emerged victorious established authoritarian regimes to secure order and the phenomenon of “caudillismo” became pervasive, North says. But new conflicts appeared with those who had inherited rights from the royal regime as they were in fundamental conflict with the interests of the new governing elites and their supporters. Huge land grants had been given to wealthy individuals as well as to the church elites. A series of local monopolies in production and trade had also been authorized to be managed by some family groups. The result was, and still is, continuous political instability, extensive rent-seeking behaviour at expenses of productive activities, adverse income distribution, a really poor provision of public goods, and a huge number of people suffering from an extreme poverty situation. North concludes that the endowment arguments for explaining growth and development must be fundamentally supplemented by the powerful consequences the path dependent colonial heritage have on both informal and formal institutional arrangements.

All these arguments are, of course, debatable. However they reveal that some analyses by North also contain references to distributive issues, conflict of interests, and groups of people with diverging capacities to influence the rules of the political and economic games being played, letting aside their differences as players under the existing rules. In North (2005:165) he also writes: “As noted above, alteration of the economic rules entails winners and losers and it is essential to be aware of them...” In 1990 North (1990:16), had already explicitly stated: “Institutions are not necessarily or even usually created to be socially efficient, rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules.” In a similar sense another ex-president of ISNIE, Eggertsson (1996, p.16), explicitly stated that the NIE perspective “also provides an opportunity for explaining the institutional arrangements than affect the relative power of workers and employers, and exploring how these power relationships emerged and how they are maintained... The framework does not suggest that all institutional change is explicitly designed to increase aggregate wealth as many critics seem to believe. Purposive institutional change reflects both the power and interests of those who control institutional change and the process for making decisions in the political sphere”.¹⁸

Knight and North (1997) and Knight (1992) are also two classic examples of contributions by self-labelled NIE oriented scholars that address distribution issues when analysing the transactions taking place in different institutional settings. Knight states that the

¹⁸ See also Eggertsson (1995, pag. 48).

emphasis on the total benefits a group of people get from the institutional arrangements under which they exchange (or organize collective action) fails to capture crucial features of the many institutional reforms we see all over at different political levels. Distributional aspects and the social conflict that emerges when there is no easy way to sort out unanimously agreed reforms are key components, Knight says, to be taken into account for explaining changes in formal as well as informal institutions. The asymmetries among participants that often exist are key explanatory factors too in Knight's view. Knight (1992, pag. 17) states: *"The main consequences of this analysis is that the ongoing development of social institutions is not best explained as a Pareto-superior response to collective goals or benefits but, rather, as a by-product of conflicts over distributional gains. In order to avoid unnecessary confusion, let me underscore here that the claim that explanations of social institutions should invoke distributional effects does not imply that such institutions do not provide some measure of collective benefits"*.

Many other examples could be mentioned here as regards to Knight's analysis. In page 194, for example, he mentions that these distributional aspects are key explanatory factors to be taken into account for explaining not only these institutional reforms we see in current democratic societies, but also for explaining, for example, *"the manipulation of the electoral institutions (that) can be found in the assemblies of Rome in the fourth century b.c."*. Because voting and representation were organized along tribal lines in these assemblies, the outcomes could be altered by redrafting the eligibility requirements for tribal membership. In year 312 b.c. when Apius Claudius wanted to provide greater influence to the emerging commercial interests in the urban areas, he tried to reform the electoral laws by allowing residents of the four urban districts to register as voters in the tribes of their choice. Several years later the Law was changed again and the eligibility requirement were redrafted again to restrict urban voters to their original four urban districts. Those who sought to retain the basic agrarian nature of Rome at those years could still retain a favourable institutional framework to their interest for a while, Knight says.

Some contributions Barry Weingast and others, such as North&Weingast (1989) or Weingast&Marshall (1988), or Weingast (1989), might be also mentioned as examples of analysis in which power influences and distributive issues are taken into account. In the classic and very much cited paper by Weingast and Marshall (1988), these authors mention that the control over the agenda within their jurisdiction by the Committees in the USA Congress implies that a committee has veto power over the proposals of others. Agenda power allows committees to bias the outcome in favour of the alternatives they prefer most. The agreements made among members of a committee or between members of different

committees are simply enforced by the property rights over seats system already mentioned. A legislator on committee i gives up influence over the selection of proposals in the area of committee j in exchange for members of committee j 's giving up their rights to influence proposals in the area i . Institutionalizing control over the design and selection of those proposals that will come to a vote substitutes for purchasing the votes of others in an explicit market. Since committees afford their members a disproportionate influence over the policy choice within their jurisdiction, representatives from farm districts, for example, are much more likely to bid for seats on agriculture committees than they are for seats on urban, housing, or merchant marine committees.

There can be no doubt that distributive considerations are present in Weingast's analysis. The diversity of interests among legislators, Weingast says, creates gains from exchange within the legislature. But under a logrolling system, votes are usually *sold* and *bought* for a *price*, with the equilibrium prices determining vote trades and hence the set of bills passed. Legislators are better off, Weingast says, by giving away votes on issues that have lower marginal distributive impact on their districts (and therefore on their electoral fortunes) in exchange for votes on issues having larger marginal impact. But what if bills that are going to come are not known in advance? Or what if future events modify the payoffs of bills already exchanged? Or what if a legislator changes his mind and his perceptions of an issue that was previously subject to exchange? In a pure exchange system or simple logrolling the time dimension cannot be fully taken into account, consequently the enforcement of agreements remains exogenous. It is unlikely that agreements will cover more than one legislative session. A variety of exchange problems arises because the value of today's legislation significantly depends on next year's legislative events, Weingast writes. Even if no change in seats has occurred, members of future sessions may face different incentives from those faced when the trade occurred and may seek, for example, to amend, abolish, or simply ignore previous agreements. Moreover, these settings inhibit the ability of reputation to serve as the sole enforcement tool. There must be little doubt that the analysis Weingast makes in this paper is a good example too.

The above mentioned contributions are offered as examples. No attempt to elaborate a complete survey is made here. And of course, several other contributions in a similar line could be mentioned. Libecap (1989a) and (1989b), Winiecky (1994), (1996), and (1998), Barthan (2004), (2000), (2001), (2005), Greif (2005) are some other examples. Even in the industrial-business organisation branch of NIE we can find some examples of analyses in which distribution issues, bargaining strength and control aspects are mentioned. Williamson (1996a: "*Efficiency, power, authority and economic organization*") (1997: *Hierarchies, markets,*

and power in the economy: an economic perspective") and Menard (1997) (2004, pag. 39-45)) are outstanding examples as they refer even to the "power influences" that emerge from hierarchical relationships and are necessary to assure control over assets. In future extension of these ideas all these contributions will have to be further examined.

4. EFFICIENCY AND DISTRIBUTION: THE TWO SIDES OF ALL TRANSACTIONS IN MARKETS AND GOVERNMENTS.

The above comments and citations reveal that several well-known outstanding new institutionalists do in fact account for distribution aspects in some of their analyses. However, in order to end the present paper a new question must be addressed. How significant are these distribution aspects? Or, let me ask it differently: do economic agents care about efficiency considerations exclusively or do they always pay attention to distribution aspects too? I think the obvious answer is that an eye is always put by us all on distribution when participating in economic transactions, selling and buying, investing, making international alliances, outsourcing, etc. As regards to private firms, the attempts to increase efficiency by reducing production and transaction costs usually are just instrumental decisions in order to obtain more profits, increase the market share, and so on. What about the collective political decisions aimed at institutional reform through the central, regional or local political processes that exist in western democracies? Are these reforms, at least, partially influenced by distributional considerations on the part of relevant actors? Do changes in the institutional-legal environment also affect the current and future share of the total output obtained by participants as income? Again, I think that the obvious answer is yes in all these cases too: institutions matter for transaction costs and efficiency, but they also matter for distribution.

A simple and stylised example can help us to show how significant these distribution aspects usually are and how are they related to the formal and informal institutional arrangements framing people's interaction in markets and governments. Many other examples could be examined as a way to end the present article. Though it is possible to make a graphical presentation of such an example, the extension assigned to the present contribution makes it impossible to do so. In a nutshell, this stylized situation can be defined as formed by two persons who interact in a shared room with no easy access to fresh, pure air. One of them smokes and the other does not. So, the level of smoke generated in the room, in case, represents a "good" for the smoker as he subjectively feels better by so doing, and a "bad" or negative external effect for the non-smoker. The situation can be regulated or framed by two alternative legal-institutional frameworks: Institutional framework 1 allows for smoking;

institutional framework 2 prohibits smoking except if all affected participants agree on the contrary. In both cases, voluntary (market) exchange can occur for the participants to see whether a better solution for both of them can be found if compared with the situation resulting from the initial assignment of rights that each alternative framework produces.

Eggertsson (1990, pag. 107) referred time ago to this stylized example for mainly stressing that if transaction costs are high the potential benefits of voluntary market exchange between the two participants may not be fully realized. Therefore, efficiency could be increased if the said institutional-legal framework could be altered in the direction of reducing those transaction costs that make exchange too costly for them. As it is usually emphasized in the NIE camp, institutional-legal frameworks matter for the costs of transacting, for efficiency and for economic growth. Though Eggertsson concentrates on efficiency aspects and does not make a comparative analysis of the alternative distributional impacts resulting from the two institutional settings considered¹⁹, his analysis can be extended very easily. The said stylized example serves to stress that institutional-legal arrangements are key factors for determining the distribution of rights and entitlements that exists in any arena and, consequently, influencing the capacities of involved participants to choose, act, bargain and so on, *ceteris paribus*. This is always the case regardless the total amount of transaction costs resulting from each institutional-legal environment. Moreover, the example also serves to show how institutional reforms may alter the prevailing distribution of rights and, consequently, affect not only transaction costs and the total output produced by participants (efficiency considerations) but also the share of that output each participant obtains in the form of current and future income and wealth. The above mentioned stylized example allows for showing these impacts very clearly, with an analysis that is fully compatible with the methodological foundations usually adopted by the new institutionalists.

Let's consider first a hypothetical situation in which the legal-institutional framework allows smoking at work facilities, it seems obvious that in our example it is the smoker (let assume that he is a man – person A) who owns the right to initially decide upon the level of smoke that will be contained in the shared room. This means that he can smoke whenever he feels the necessity to do so. The other person (let's assume that she is a non-smoker girl – person B) would suffer from a polluted working atmosphere, particularly if there is no easy way to get new, fresh air in the room. If our two participants were people that only care about their own interest but still were open to dialog and exchange, it is reasonable to think that an agreement between the two might be achieved. The said institutional framework would very

¹⁹ In page 109 he just mentions that “the assignment of property rights to an individual produces a kind of wealth effect that influences his or her valuations.

much influence (together with some other factors not taken into account in our stylized analysis, of course) the nature-direction and the terms of this potential exchange, with person B (the non-smoking girl) having to pay person A in order for him to smoke less. How much person B would pay will depend on many factors that are out of our stylized picture. However, one of these factors can be mentioned here in order to compare this situation with the new one that will be considered next. What about the bargaining strength of each participant to get as favourable voluntary exchange as possible, given the institutional circumstances considered, *ceteris paribus*? The institutional setting affects this bargaining strength too. In our case, the non-smoker is in a much more unfavourable situation to enter exchange as compared to the situation experienced by the smoker. The smoker can initially decide what is best for him and then try to see whether an exchange is possible, letting aside the he could also behave strategically and smoke even more than desired during the days where negotiations were taking place. The institutional-legal framework greatly affect the starting point from which people enter market negotiations and consequently the feasible alternatives they confront as well as their relative bargaining capacities, *ceteris paribus*. Therefore, it can be said that the terms of the exchange may be, in part, influenced by the institutional arrangements framing the said interaction.

But the story can be extended. As mentioned before, institutional changes affect not only the total amount of transaction costs experienced by participants, these changes also produce distribution impacts. That is why monetary payments are often needed to compensate those participants who might be harmed (or expect to profit less) as a result of a reform. To extend the analysis based on our stylized example, let's assume that through the political process a change in the said legal environment is implemented. This change can be assumed to be exogenous to our analysis for reasons of simplicity. Let's assume that smoking at work facilities is no more allowed except if all persons involved in the same room agree on the contrary. Under the new legal framework, the right to initially decide about the level of smoke in our stylized situation would in fact pass from the smoker A to the non-smoker girl B if both are normal persons that voluntarily obey the law. And this new assignment of rights resulting from the reform drastically changes the situation that is confronted by our two participants, also affecting the nature and the terms of the potential exchange that might occur, in case. That is the new institutional setting affects the share in the benefits resulting from exchange under the circumstances. In the new institutional setting, it seems evident that the best choice for the non-smoker is getting the room free of smoke, as the smoke diminishes her well-being (utility). It is evident that this institutional change would have a tremendous distributional impact on the well-being of both participants as compared to the situation in which smoking was allowed, *ceteris paribus*. Before exploring any possibility of voluntary exchange, now it is the non-

smoker girl who has the right to decide what is best for her as regards to the level of smoke in the shared room. This level would be zero according to our simple, stylized assumptions. As a result, the smoker would be now in a desperate situation for obvious reasons, particularly if he cannot leave work for smoking at the street. His capacity to bargain in order to get as favourable exchange as possible has radically diminished too if compared with his capacity to do so in the previous institutional setting. If our two stylized participants entered voluntary negotiations to see whether an agreement could make both better off, it is evident that now the new institutional framework would require the smoker A to voluntarily pay person B for allowing him to smoke and pollute the atmosphere of the room. Previously, it was the non-smoker who had to voluntarily pay the smoker for him to smoke less. The institutional setting also influences the bargaining capacities of traders. Now the non-smoker agent B is in a better position to get a more favourable exchange than before.

Therefore, it is evident that our stylized example serves to stress that institutional arrangements and institutional changes also affect distribution no matter whether market exchanges are possible or not. Even if transaction costs are very low and exchanges can take place for making all parties better off, the final result depends, in part, on the institutional arrangement framing their voluntary interaction under the circumstances. Several other real case examples could be mentioned here. The well-known 1914 Miller and Shoene Virginia Court case is one of them. Because it happened time ago a more distant analysis can be made. Briefly, this was a case which involved red cedar trees and apple trees and their respective owners as a result of a plant disease that suddenly might come up. Initially the fungus appeared living on the ornamental red cedar trees without any adverse effect on them. During a second phase it severely could damage the apple trees that were sufficiently near, causing complete destruction of the fruit and leaves.

In 1914, the legislature of the state of Virginia passed a statute which empowered the state entomologist to investigate and, if necessary, condemn and destroy without compensation any cedar tree that had the fungus within a two-mile radius of an apple orchard. This was an institutional reform that changed the legal rules governing the inter-relationship of red cedar and apple trees' owners and their potential voluntary exchanges. The cedar tree owners first brought a suit in the state courts, and after it arrived to the Supreme Court. The thrust of the cedar tree owners' argument as a whole was that the statute was an unconstitutional exercise of police power. However, the Supreme Court rejected the claim of unconstitutionality saying that the Legislature was under the necessity of making a choice between the preservation of one class of property and that of the other wherever both existed in dangerous proximity. It would have been none the less a choice if,

instead of enacting the new statute, the legislature, by doing nothing, had permitted serious injury to the apple orchards within its borders to go unchecked. When forced to such a choice, the legislature does not exceed its constitutional powers by deciding upon the destruction of one class of property in order to save another and, in case, regulate the potential compensation payments to be made. The new statute altered the effective assignment of rights upon which voluntary market transactions might be made. Of course, the legislature could have allowed for private agreement among conflicting parties before or after the approval of the new statute, which was not the case. However, the result of such a voluntary agreement among parties would have been different depending on the legal framework in place. Without the new statute, only by paying the red cedar owners for cutting down the affected trees might the apple owners avoid damage if the fungus were to reach their apple trees. With the new statute in place, if such a voluntary agreement (voluntary under the circumstances) had been permitted the red cedar owners would have had no other option than to offer a compensation payment to the apple trees owners in order to avoid cutting down their red cedar trees when the fungus appears. Because voluntary market exchanges always occur within legal-institutional frameworks, it is evident that these frameworks (together with other factors not being considered here) greatly affect the initial allocation of resources and the effective rights enjoyed by involved participants, their relative bargaining strength, the risk each of them confront if the exchange fails, etc. The nature and terms of the exchange in part depend on the legal-institutional arrangements in place.

The apple and cedar trees Court case also shows that the relevant issue is not whether legislatures must intervene or not but who will exercise more influence on political decisions aiming at institutional reform. Apple orchards were a major *industry* in Virginia at that time. Red cedar trees were of primarily ornamental uses. The apple owners were organized and influential whereas the red cedar owners were not. These are also relevant factors for explaining institutional reforms emerging from central, regional or local political processes.

Some other real case examples could be examined if the extension of this contribution was not limited. Consider the efficiency and distributive impacts that might result from reforming the central and regional legislations regulating how many holidays can shops be open in a year in Spain, for example. If a reform was introduced for the owners of these shops to “freely” choose to open as many days as they liked (now this is restricted), it is evident and well-acknowledged that the small, traditional shops in big cities will be negatively affected as compared to those other located in the big shopping centre’s areas. I cannot go further but to provide some final remarks to end this contribution.

5. FINAL REMARKS.

Coase, North, Williamson, Menard, Eggertsson and many other new institutional economists have been able, particularly since the mid 1990s, to make it clear for almost everybody that “*institutions matter for economic performance*”. Formal and informal institutional arrangements are seen now as key factors influencing the total amount of transaction costs confronted by participants in all economic arenas, and consequently the degree of efficiency characterizing their activities and achievements.

However, these are not the aspects that have called my attention in the present article. Here, I have tried to demonstrate that some well-known new institutionalists also account for distribution aspects when analysing the working of markets and governments. I have stressed that institutional arrangements and institutional changes also have distributional consequences regardless whether voluntary exchange among participants takes place or not. Because of these expected distributional impacts resulting from alternative institutional reforms, some groups of people may oppose to a new legal reform even when there is a generalized perception that total transaction costs will be diminished, *ceteris paribus*. Reducing specific transaction costs through feasible institutional reforms in order to make market transactions or governmental collective choices more efficient does not eliminate the possibility that some participants may nevertheless be negatively affected as a result in terms of the income they are able to get after the reform, particularly if no compensation payment is agreed on. They may even reject this payment and be in favour of an alternative efficiency enhancing reform if they expect it to better serve their interests, whatever they are. In many occasions there are legal or institutional barriers that create transaction costs for some agents but, at the same time, are the tools other agents use to ensure higher incomes for themselves in market or political transactions.

Let me just conclude by stating, once more, that distribution aspects are so pervasive that they deserve, I think, a place in the NIE approach whenever they are considered relevant for the research task at hand. Why not? As the examples examined here show, the analysis can be extended so as to account for both the efficiency and distribution aspects that are usually involved in people's transactions through markets, governments as well as many other institutional arrangements. Let me say again that there is nothing in the basic assumptions, criteria and methods usually adopted by the NIE oriented scholars that makes such an extension not possible. Though many authors in the NIE tradition often focus on transaction

costs and efficiency exclusively, here I have shown that some well-known NIE scholars have paid also attention to distribution issues in some of their contributions, particularly in the so-called political economy of institutions and decisions branch of NIE. The institutional-legal framework greatly affect the starting point from which people enter market exchanges and consequently the feasible alternatives they confront as well as their relative bargaining capacities, *ceteris paribus*. The terms of the exchange are, in part, influenced by the institutional arrangements framing interactions in all economic arenas, let aside some other relevant factors deliberately excluded from consideration in the stylized examples here presented.

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