

NEW INSTITUTIONAL ECONOMICS TWO APPROACHES: INSTITUTION-AS-RULES AND INSTITUTION-AS-EQUILIBRIA

Artur Borcuch¹

¹ Ph. D., Institute of Management, The Jan Kochanowski University in Kielce, Poland.

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Abstract

In this article I study some of main approaches to new institutional economics: institution-as-rules and institution-as-equilibria.

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1. Introduction

Institutional economic is an economic perspective that attempts to extend economics by focusing on the social and legal norms and rules that underlie economic activity.

As D. C. North suggests, formal institutions intend to reduce the transaction costs based on regulations¹. Whereas informal institutions exist to reduce the uncertainty caused by the decision making of all individuals².

2. Theoretical overview

There are two methods of an institutional analysis. Institutions-as-rules approach (D. North) and institutions-as-equilibria approach (A. Greif, M. Aoki). The institutions-as-rules approach has been complemented with other important approaches within NIE (New Institutional Economics). Greif and Kingston and E. Brousseau, P. Garrouste, and E. Raynard distinguished two areas of new institutional theories. On one hand, according to North, institutions are viewed as rules imposed on individuals, whereby the focus is on the strategic games among coalitions that aim to promote or block new rules. On the other hand, according to M. Aoki and A. Greif, the mutual expectations about others' behaviors may configure self-enforcing institutions, and institutional change is studied as a switch of institutional equilibrium. The institutions-as-rules approach assumes that rules are exogenously predetermined by the existence of a hierarchical order. When institutions are presented as rules, the enforcement of the rules is considered a distinct issue from the formation and content of the rules themselves, and institutional change is about changing the rules. In this case, there will be coalitions of agents supporting new rules and coalitions looking for the status quo³.

The core idea in the institutions-as-equilibria approach is that it is ultimately the behavior and the expected behavior of others rather than prescriptive rules of behavior that induce people to behave (or not to behave) in a particular way⁴. The institutions-as-equilibria approach provides an analytical

¹D. C. North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge 1990.

²D. C. North, *Understanding the Process of Economic Change*, Princeton University Press, Princeton 2005.

³G. Caballero, D. Soto-Oñate, *The Diversity and Rapprochement of Theories of Institutional Change: Original Institutionalism and New Institutional Economics*, "Journal of Economic Issues" 2015, Vol. XLIX, No. 4, p. 964.

⁴A. Greif, Ch. Kingston, *Institutions: Rules or Equilibria* [in:] *Political Economy and Institutions, Democracy and Voting*, N. Schofield, G. Caballero (eds.), Springer-Verlag, Berlin-Heidelberg 2011, p. 25.

formulation in game-theoretic perspective for the view of institutions as spontaneously and/or endogenously shaped and sustained in the repeated operational plays of the game itself. In this approach, institutions are salient effects of the societal games played, being played, and believed to be played in a population, wherefore the approach calls for equilibrium thinking. When institutions are viewed as equilibria, a theory of motivation is placed at the center of the analysis, and the evolution of behaviors and beliefs implies the process of institutional change. Therefore, the study of the way new shared beliefs emerge is crucial in this approach. Assuming that institutional dynamics involve interactions of economic, organizational, political, and social domains, Aoki showed that equilibrium of the game - an institution - cannot be sustained in a single domain, independently of other domains. Studying the dynamics counterparts of institutional linkages and interdependencies across domains, Aoki presented three mechanisms of endogenous, interactive institutional change: dynamic institutional complementarities, overlapping social embeddedness, and Schumpeterian bundling innovation. These mechanisms demonstrate the complexity and interlinking of past, present, and future institutions⁵.

3. Summary

The institutions-as-rules approach, identifies institutions as the rules of the game in a society, including both formal rules such as constitutions and laws enforced by the state, and informal constraints. The institutions-as-equilibria approach focuses on motivation provided by beliefs, norms, and expectations that both shape individual behavior whilst simultaneously themselves being a product of the strategic interplay between agents (individuals or organizations).

4. References

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⁵ G. Caballero, D. Soto-Oñate, *The Diversity and Rapprochement of Theories of Institutional Change: Original Institutionalism and New Institutional Economics*, "Journal of Economic Issues" 2015, Vol. XLIX, No. 4, p. 964-965.