37. Experience, Theory and Design

Franz-Xaver Kaufmann, Giandomenico Majone and Vincent Ostrom

Abstract

The editors summarize the thrust of the present volume. It combines current approaches in the American social sciences with European traditions of thought in order to assess the impact of the still ongoing differentiation of government and its growing interdependence with nongovernmental public and private bodies. By analyzing characteristic patterns of coordination as institutional arrangements, a way has been opened to the search for institutional design. Taking into account the constraints of rational decision making, standards for institutional design should give more prominence to the possibilities of feedback and learning, i.e., to the social processes of evaluation than to the rational processes of calculation.

37.1 Specialization and Coordination of Effort

The experience of different peoples, who have shared an active role in the development of modern civilization, has been one of rapidly expanding knowledge and technologies. Advances have been especially marked in the physical sciences with new sources of energy and new forms of technology that have greatly amplified human productive potentials. The variety of goods and services available for human use and enjoyment has increased with a radical expansion in both the variety and scale of tools that can be used as instruments of production to yield still other goods and services. The craftsman who carries his tools to work can be contrasted to the workman whose place of work is a large assemblage of tools housed in factories.

These developments have been accompanied by an increasing division of labor in many different types of human endeavors. Teamwork makes it possible for human beings actings jointly in teams and in teams of teams to accomplish tasks that cannot be accomplished by the same individuals acting alone. The jointness and interdependence of teamwork, in turn, depends upon complex structures of shared understanding where relationships are organized by working rules in many different types of going concerns (Commons 1924). The great number and variety of organizations reflects the way that rule-structured relationships in one enterprise or another is coordinated with the instruments and processes of production to yield a great variety of artifacts and artifactual states of affairs that shape the conditions of human livelihood.

The levels of achievement attained through joint endeavors and hence long chains of actions are always exposed to potential threats where some individuals have opportunities to function as free-riders by shirking in the performance of their efforts and yet hoping to share in the aggregate yield achieved by teamwork. But

shirking has an adverse affect upon yield; and joint productivity in teamwork suffers unless performance can be monitored to maintain appropriate levels of achievement. Threats also arise from the exercise of differential claims to shares in the return from joint productive efforts and the way that responsibility is differentially allocated for determining how each individual shares in that return from joint productive efforts. Some exploit opportunities for increased productivity through joint effort by free-riding, or what might more aptly be called easy-riding; others exploit opportunities by dominating collective decision structures and deriving disproportionate returns from the joint endeavor. Problems of rule-ordered relationships abound in the organization of joint enterprise requiring elaborate patterns of coordination.

These problems are even more critical in the public sector where the nature of the goods or services being supplied typically pose difficult problems of measurement, and where the desired levels of achievement may depend upon the coproductive efforts for those who are being served (Wirth: Ch. 35). Under such circumstances, proximity to the community of people being served, their conditions of life and preferences, are variables that are of importance in achieving and assessing performance.

Where conditions of joint use or enjoyment of goods and services occur among communities of people, similar problems to those that arise in organizing joint production are faced in organizing joint consumption. Where exclusion is infeasible or difficult to achieve, individuals may have incentives to take advantage of whatever is made available without assuming a commensurate responsibility for contributing to the joint provision of the collective good or service. Free-riding occurs among communities that make joint consumptive use of collective goods and services. Free-riding among a community of service users on the consumption side of a public economy occurs under much the same circumstances where the yield of producers is difficult to measure. Commensurate opportunities for shirking exist in both the production and consumption of public goods and services.

The challenge is how to avoid the circumstances where joint use of common-pool resources and common facilities works its way through to tragic consequences, and how to facilitate and maintain patterns of reciprocity among people linked by long chains of action. How can they be kept in mutually productive communities of relationships? This requires differential assignment of authority and patterns of accountability in interdependent decision structures whenever substantial division of labor or specialization of efforts occurs. Achieving constructive ways of organizing patterns of supply to meet desired levels of service and creating complementary patterns of use among communities of users requires complex patterns of organization among the communities of people who are involved.

Commensurate division of labor and differentiation of efforts has occurred in the exercise of the basic prerogatives of government. Patterns of governance in all Western societies have been marked by a differentiation of legislative and judicial functions from the exercise of executive functions. A close examination of legislative bodies reveals an extraordinary complex structure of teams of teams organized predominantly as collegial work-groups in a manner that is characteristic of mutual adjustment by debate and persuasion (Majone: Ch. 21). In turn, different systems of courts, each court in its own operation, and the relationship of any one court to

other courts represent complex patterns of teamwork in both joint and adversarial relationships.

The differentiation of rule formulation from rule implementation implies that rules have a potential for a publicness of meaning so that communities of people have shared standards of reference in ordering their relationships to one another. The publicness of standards is reinforced by requiring the concurrence of judicial authorities before criminal sanctions can be mobilized and used by executive instrumentalities of government. Law as a medium for the ordering of human relationships acquires a publicness that accrues from contestation about the meaning of law in the context of prospective (legislative), concurrent (executive), and retrospective (judicial) assessments.

The reciprocal processes of specialization and coordination of effort occur within processes that are marked by varying patterns of symmetry and nonsymmetry in human relationships (see the contributions of Ostrom and Shubik in Ch. 11). Where patterns of exchange and reciprocity occur among equals, substantial degrees of symmetry can exist in human relationships. But many relationships, including the rule-ruler-ruled relationships, depend upon nonsymmetries such that some are assigned authority that can impose limits and enforce rules in relation to others. No one, among human beings, is omniscient; and each depends upon the knowledge and skill exercised by others. Nonsymmetries in knowledge and skill occur in different patterns of relationships than those that apply to the exercise of authority.

While nonsymmetries are a fundamental and necessary feature of relationships in human societies, there remains the possibility that nonsymmetrical relationships can be linked in ways that yield increasing degrees of symmetry among nonsymmetrical structures. When such occurs, those who exercise the essential prerogatives of rulership, for example, may be linked in decision structures that make them dependent upon collective decision processes that are exercised by those who are, in some circumstances, their subjects. Those who are subjects, in some circumstances, are citizens, in other circumstances, where they exercise important prerogatives of rulership over those who are governmental officials. By rotating the nonsymmetrical assignments of authority through time, communities of people may come to share a symmetry of understanding about the more general community of relationships implied in the structure of nonsymmetrical relationships. The linking of nonsymmetrical patterns of relationships in ways that yield increasing symmetry implies that larger patterns of interdependency are created in the nexus of human relationships.

37.2 Institution Building as Condition for the Lengthening of Chains of Action

The division of labor and the fragmentation of power as basic features of modern societies from the starting point for our inquiry to explain the operation of what is conventionally called "the public sector." It has been shown in Part 2 that traditional differentiations of economic and political theory such as state/society,

public/private, or policy/economy lose their accepted meaning because they are far too simple to explain what goes on in organized public life. We are, therefore, aiming at a more complex and abstract approach which should enable us to deal with issues of public policy in terms of an interaction between public and private actors or – in more sophisticated terms – an interpenetration of political, economic, and social systems. The growing public sector has, therefore, to be conceived as a multibureaucratic structure rather than a megabureaucratic structure. A multiplicity of organized bodies are interacting within more or less loosely coupled networks, and their interactions are only partially (and to a variable extent) regulated by law. This multiplicity of organizations is built upon structures that are of a formally public or formally private status. Legislatures, for example, are formally public; but in many societies political parties as well as "peak-associations" (see Franz et al.: Ch. 26) are formally private. Yet, they both assume essential roles in organizing the processes of government. To conceive formally private organization as belonging to "the public sector" means that their performance depends upon the exercise of governmental prerogatives and, therefore, implicate some kind of public interest. The public sector cannot be conceived as a boundary maintaining system. Rather, it is an integrating arrangement for multifarious and multidimensional areas of society that are considered in the common perspective of being influenced by associated governmental activities (cf. Gretschmann: Ch. 7; Shubik: Ch. 28). In a more substantive perspective, one should speak rather about public sectors in the plural in order to state the problem correctly. It consists mainly of a variety of interorganizational networks that are focused on specific policy areas. These interorganizational networks are described in e.g. Chapters 8 and 9 and are analyzed more generally in Part 5 (see e.g. Franz: Ch. 23).

If the public sector cannot be conceived as a single "system" in order to account for the high variability of contested issues, types of organization, patterns of interaction, and modes of coordination, how then is the basic problem to be conceived that allows for an unifying approach? The basic idea with which this volume starts is the problem of coordination of a multiplicity of actors. These (individual or organized) actors are conceived as having a potential for self-regulation, as having resources and interests, as being able to act, to know, and to learn in light of performance within their social environment. All these features are given as variables, i.e., there is no equality assumed among the actors, their relative strengths and potentials are matters of fact. It is, however, assumed that every actor has potentials to react to the behavior of other actors so that agreement or disagreement, cooperation or conflict, affects the costs of particular actions.

Coordination of a multiplicity of actors cannot mean that *all* the actions of these diverse actors are coordinated by a single central steering mechanism. Such an utopian approach neglects the need for self-regulation within multiple actors and underestimates, therefore, the costs of conformity and the losses of adaptive potentials present within the various actors. Hierarchic coordination by a center is, of course, an important mode of coordination; but it is a specific form of coordination that never relates to all the actions of an actor. We therefore conceive the coordination problem as related to actions and not to actors. Coordination happens, insofar as different actions of various actors become linked to constitute *chains of actions*.

Considering the multifarious and multidimensional structure of relationships within the public sector, it becomes obvious that most actors are engaged in a multiplicity of chains of action and that there is a constant striving on the part of the different actors to reconcile the demands from various parts of their social environment with their own resources and interests. There also exists, therefore, a problem of internal coordination within actors in order to behave efficiently. If we focus upon internal coordination, we have to consider separate actors as self-regulating systems. Our main focus is, however, upon the inter-systemic relationships that are conceived here as a problem of establishing extended chains of actions.

If we consider that for most purposes within the public sector the establishment of the relevant chains of action necessitates the cooperation of more than two actors, it becomes obvious that the issues involved here cannot be conceived exclusively as a problem of interaction between two systems. The chains of action, which are of interest, have, so to speak, a large number of links among various systems and we have to explain therefore the establishment of longer chains of actions that transcend the realm of direct interactions. This has led us to distinguish operational coordination (i.e., in the immediate context of actions and interactions) and institutional coordination as the establishment of configurations of rules with coordinative power among multiple action arenas. Operational coordination can be improved substantially when it takes place in the context of rules that are known to the actors concerned.

Our concern in this volume is, however, not with all sets of rules that may ease operational coordination – it is hard to imagine rules that might not produce this effect in particular circumstances. We are only concerned with configurations of rules that are related in a systematic way to the improvement of coordination processes among actors. We, therefore, had to analyze the coordination problem in terms of guidance, control, and feedback. From an analytic perspective, coordination depends upon solutions to three problems: (1) the problem of guidance, i.e., standard-setting such that the actions of particular actors may be evaluated in terms of their reference to third parties; (2) the problem of control, i.e., the motivation and the information of the actors in order to promote the complementarity of their actions; and (3) the problem of feedback, i.e., to enable evaluations including those made by third parties to be taken into account in modifying further actions (cf. Kaufmann: Ch. 10). Insofar as institutional coordination is concerned, the rule configurations are not necessarily efficient in guiding, controlling, and evaluating particular actions as such, but in establishing frameworks that provide for procedures in deviant cases and for promoting regularities and reliabilities among actors and chains of actions.

37.3 Causes, Norms, and Reasons: The Interplay of Analytic and Normative Inquiry

The aim of this volume has been to provide empirical evidence, theoretical foundations, and conceptual tools for better understanding the operations that take

place within what is conventionally called the public sector. This is an analytical as well as a normative task. Insofar as activities have to be considered as belonging to the public domain, one cannot judge them primarily in the perspective of individual interests, but one has to assume that they serve a public interest – whatever this means. The substance of what is referred to as being of public interest as well as the scope of the public domain are always contested issues in democratic societies. Under these circumstances, scientific work has to be concerned mainly with the conditions and procedures which, despite the contestability of nearly every issue of public interest, allows for an assessment of patterns of development in relation to standards of performance (cf. Hellstern: Ch. 14).

Given the great variety of political theories, constitutional provisions, institutional arrangements, and administrative cultures among Western societies, it is very difficult to ascertain common patterns of regulation that apply to the public sector. The thrust of the research group consists, therefore, in an attempt to find conceptual tools that account for both common features and differences in the problem and functions of public sector activities.

In trying to draw general conclusions from our inquiries, one has first to record that guidance, control, and feedback within the networks of multiple actors in the public sectors cannot be explained by reference to a single pattern of institutional arrangements. There is not a comparably elegant theory to market theory for explaining coordination among private enterprises. The fit of standard setting, control of producers, and provision for the needs of citizens/taxpayers/consumers can by no means be taken for granted in public services. This is due mainly to the fact that public services are expected to serve a variety of different goals and are evaluated by a multidimensional set of standards (e.g., legality, economy, effectiveness, responsiveness) that cannot be reduced to a unidimensional standard of cost or utility. The reason why the production of goods and services is of public interest is to be seen in their impact upon political, cultural, or social aspects of life. If – as in market theory – the mechanism of competition and floating prices for commodities is judged to be a convenient form of coordination, this amounts also to the acceptance of money, as a medium of exchange, as, simultaneously, an appropriate measure of utilities and interests.

Standard setting and standard using (evaluation) is therefore necessarily a *multidimensional* issue in the realm of public interest. This fact complicates the problem of coordination as well as the problem of understanding the nature of the public realm. The operating ideologies of practitioners (and often also of scientists in close association with some policy area) tend to emphasize particular dimensions of a policy problem and to neglect others. Thus, there necessarily seems to be conflict among different interests that cannot be readily settled by established rules of law or by cost-benefit analysis.

Practical solutions to this multi-goal and multi-standard problem have occurred within particular national traditions. One finds, however, a common feature: Particular organizations are created to pursue specific goals, and particular organizations are charged with evaluation and control with reference to particular standards or criteria (e.g., law courts for legality and auditing courts for economy, cf. Part 6). In other words, a strong division of labor within the public sector occurs with reference to tasks to be accomplished or criteria to be applied. But, there is no

"common denominator" (such as market prices) that facilitate the necessary bargains and transactions in accommodating extended chains of actions. The public sector is necessarily fragmented, and so are the operating controls. This, however, does not mean that control lacks regularity. Rather, one may ascertain various patterns of control linked to specific standards and accessible to specific monitoring arrangements (cf. Dunsire: Ch. 16; Wirth: Ch. 29). From a political point of view, then, the question is inevitable which interests have access to what forms of control and to what extent the standards used fit the needs and interests of those involved in the larger configurations of relationships in human societies. This leads not only to questions of ethics (cf. Chs. 11 and 13) but also to issues of institutional design as have been sketched in Part 4.

From a more analytic point of view, our problem can be stated as follows: How can such a multiplicity of actors with particular interests coordinate their actions in order to produce outputs that are consistent with the interest of third parties? As has been shown, this can be explained only by using a multilevel approach to issues of guidance, control, and feedback, and by distinguishing various types of institutional coordination with specific strengths and weaknesses. Moreover, one has to assume a redundancy of control structures in order to hold deficiencies within reasonable limits. This approach may disappoint both those who believe in the possibilities of rational policymaking and those who are convinced of the evils of public intervention. There is no easy way to political ideologies from the framework just sketched.

Our inquiry is normative insofar as it is concerned with the coordination problem. We, therefore, assume that it is worthwhile to search for the common features of institutional arrangements that support the integrative function of a shared understanding, while also allowing for flexibility and responsiveness to diverse problems requiring collective decisions. This kind of normative reasoning has to face two standard objections: First, that it is impossible to *prove* the desirability of normative standards. And, second, that even if there were substantial agreement about the issues there may still be serious impediments to institutional reforms.

Insofar as the first objection is concerned, we want to deal with it as a feature of shared experience below the level of philosophical speculations. Any normative standard – to facilitate or ease coordination – is general and open to different specifications. Coordination is possible through conflict as well as by cooperation. Both may lead to the establishment of extended chains of actions under specific institutional arrangements.

Rivalry in competitively constrained circumstances among political parties, interest groups, and bureaucratic organizations, for example, can yield coordinated chains of actions of as great or greater complexity than those attained through conscious cooperation (cf. E. Ostrom: Ch. 24). Specific arrangements and their alleged properties and consequences become a part of a larger awareness in the contestation of political debate.

Moreover, the standard by which we propose to evaluate the coordinative capacity of institutional arrangements is not taken from personal convictions, but emerge in the course of analytic inquiry about modes of coordination, i.e., by analyzing empirical evidence and theoretical explanations of coordination in the

economic and political domain. Specific norms accrue from an awareness of problems that every actor has in interaction with other actors.

The general quality of institutional arrangements that ease coordination can be described as follows: Given the limited rationality of all actors and the contestability of all political issues, institutional arrangements provide possibilities for learning among all of the actors concerned. Learning implies the experiencing of successes and failures. In order to enable coordination to occur with other actors, it is, however, necessary that successes and failures are related to the evaluations of those who are concerned with particular actions. This cannot be performed by market mechanisms alone, but depends upon various other institutional arrangements as well.

One should add perhaps some reflections concerning the image of man that underlies this presentation. Man is conceived here neither as exclusively selfish nor as being bound only to the pursuit of material self-interest (as in economic theories), nor as motivated exclusively by fear and pleasure (as in theories of dominance), nor as bound primarily by societal values and committed to internalized norms (as in sociological structuralism). Each of these simplifying approaches emphasizes a particular aspect of human potentialities and of the possible impacts of institutional ordering. Moreover, we would emphasize a fourth aspect, namely the capacity of man for sympathy, for a fellow-feeling and a sense of propriety and of justice as described first by David Hume in his moral philosophy, and by Adam Smith in his theory of moral sentiments. It is plausible to assume that in anonymous relationships as they are characteristic for highly organized market situations, men orient themselves primarily by what they conceive to be in their self-interest. The cognition of what is in one's own interest, however, depends crucially on the institutional arrangements that govern the situation. Moreover, men are capable of assessing not only their present situation but also how institutional arrangements, the configurations of norms themselves, affect those situations. It is in this respect that one may assume that a sense of justice and propriety is operative as standards of judgment applicable to diverse circumstances. Under conditions of relative equality, nobody knows whether he will eventually be among winners or losers if the rules of the game favour one-sided outcomes (cf. Rawls 1971; Buchanan and Tullock 1962). Incentives exist to strive for fairness of outcomes, given essential equalities among all concerned.

This last argument also provides some answer to the second objection to an inquiry into the possibilities of institutional design. It is, of course, undeniable that institutional reform is facilitated and hampered by contested interests, whatever its scope and content may be. And there are many examples of a resistance to changes that seem to be impenetrable to better arguments. But the veil of ignorance often makes it more difficult to assess one's own interest with respect to institutional arrangements than to operational arrangements with known payoffs. This provides oportunities to pursue institutional reforms where operational arrangements yield perverse consequences. There is enough evidence that existing modes of coordination yield perverse effects at operational levels to require further attention to problems of institutional analysis and design.

37.4 Institutional Analysis and Design

A major question that we face at this juncture in history is whether we have the rudiments of knowledge to undertake the design of human institutions and what limits apply to such design capabilities. The problem must be approached with caution because several different levels in the ordering of relationships are involved. One level is the order of relationships that accrues through patterns of mutual adjustment among human beings as they act with reference to one another. We find strong emphasis in the work of F. A. Hayek upon the patterns of mutual adjustment that are the source of endogenous change in human societies. Human institutions are marked by an evolving social order that Hayek contrasts with a planned or directed order. To speak of analysis and design is to have reference to planning, at least in some sense.

Hayek's warnings about a planned or directed order are more aptly applied to an operational level of analysis where the question is what government, organized as a monopoly of power, should do. A planned order is then a directed order subject to a centralized structure of command. Hayek has also recognized that, "the possibility of men living together in peace and to their mutual advantage without having to agree on common concrete aims, and bound only by abstract rules of conduct, was perhaps the greatest discovery mankind ever made" (Hayek 1976: 136). Rules of just conduct can apply as much to the ordering of actions as means as they can to the purposes or outcomes as ends. There is a level, then, where planning might occur in the design, creation, and alteration of rule configurations for the governance of human societies.

Alexander Hamilton, in this sense, raised, in the opening paragraph of Federalist 1, the question of "whether societies of men are really capable or not of establishing good government from reflection and choice or whether they are forever destined to depend for their constitutions upon accident and force" (Hamilton, Jay, and Madison n.d.: 3). "Good government" presumably is that type of arrangement that would be capable of reasonably high levels of performance. Reflection and choice, however, has reference to principles of organization that are not limited to a *directed* order. Montesquieu enunciates a principle of using power to check power in the design of institutions appropriate to the constitution of liberty. Madison also referred to a principle of design "where the constant aim is to divide and arrange the several offices in such a manner that each may be a check upon the other" (Hamilton, et al. n.d.: 337).

The design principles formulated by both Montesquieu and Madison presume that it is possible to design human institutions that manifest equilibrating tendencies among multiple centers of power. Planning, as applied to institutional analysis and design, need not be confined to direct command and control by a central directorate. The design of institutions based upon using rule-constrained power to check rule-constrained power through opposite and rival interests depends critically upon shared communities of understanding about the normative standards to be used to assess individual and aggregate levels of performance and to specify diversely structural processes for ordering relationships in human societies consistent with those general norms. No single form of organization is appropriate to all circumstances. Human societies require recourse to diverse modes of organization.

This circumstance permits people to learn from the experiences that are accrued in establishing institutions that enable them to cope with problems that have plagued peoples in all societies.

At a level of interpersonal relationships, where human beings learn to relate to one another in the immediate exigencies of life, distinctions accrue in routines that are appropriate to family life, play, care for others and for things, work, accomplishments, and how to relate to others in diverse circumstances. Many of the problems of sharing, exchange, reciprocity, teamwork, joint use of common facilities, rule setting, rule applying, and rule enforcing occur in the microcosm of family, neighborhood, and community relationships that are experienced from earliest childhood and throughout life.

While the microcosm of life as experienced by individuals has reference to habituated routines and relationships reflected in a wide range of human institutions, the problems of crossing the thresholds from experience to theory, and from theory to design in the larger context of human societies, is plagued with difficulties. What is bound up in complex patterns of specific relationships to particular individuals and circumstances must be transformed into generalized structures that distinguish, simplify, and specify essential elements and relationships. This is required in translating from the world of experience to the communicable symbols of human language.

Distinctions need to be made among institutions. The basic elements and relationships implicated in distinguishable sets of institutions must be indicated so that the relationships of conditions and consequences can be specified to allow theoretical inferences to be drawn. If patterns can be generalized, the generalized structure of relationships should be replicable in similar circumstances that also have their distinct individualities or uniquenesses. Efforts to distinguish, generalize, and represent are plagued with serious potential for error when removed from the context of the discrete exigencies of life. But, this is the burden of translating from what is experienced into what is knowable.

The larger configurations of relationships in human societies that go beyond the bounds of personal knowledge become more dependent upon formalized relationships that rely explicitly upon rules and systems of governance that pertain to rule-ruler-ruled relationships. The primacy of interpersonal relationships of an informal character gives way to the primacy of formally-structured relationships of a more impersonal nature. Yet, the possibility remains that generalized patterns of relationships applicable to different types of institutional arrangements, and to generalized tasks associated with each type of institution, can be specified as essential conditions pertaining to the design of human institutions.

A theory of human institutions implies that the terms and conditions can be specified and can be used as a basis for creating institutions in different societies. These may be grounded in different presuppositions, rely upon different design characteristics and imply that people would relate themselves to one another in different ways. Yet, the question remains whether different peoples might learn from one another's experience to draw upon different conceptions and explore their potential usefulness for ordering relationships in human societies in more just, reliable, or productive ways. Tocqueville once observed, in his *Recollections*, that "what are called necessary institutions are only insitutions to which one is

accustomed and that in matters of social constitution the field of possibilities is much wider than people living within each society imagine" (1970: 76).

Development of theoretical models, variations in models, and their use in design of both simple and complex organization arrangements have the potential for yielding experience that can be used to accumulate increasing design capabilities and a greater critical awareness about potentials for the design of human institutions. Democratic societies, in particular, depend upon acquiring a sufficient level of experience and knowledge to have a critical self-awareness about standards of performance than can reasonably be expected from the way that human beings relate themselves to one another in different institutions. Perfection cannot be expected on the part of fallible creatures. Thus, errors and misfortunes can be expected to occur. But, human institutions should enable those involved to learn from experience. Where errors and misfortunes persistently reoccur so that actions depart from acceptable standards of performance, people in a democratic society need to have diagnostic capabilities for identifying the "cause of their wretchedness," as Tocqueville has put it (1948: I,231), and explore the availability of possible remedies. When people are "unable to discern the causes of their wretchedness,... they fall a sacrifice of the ills of which they are ignorant" (Tocqueville 1948: I,231).

Institutional analysis and design need not be confined to decisions about what the "government" or the "state" should do, but about how institutions of governance should themselves be organized. Some of the most extreme perversities including the grossest injustices and the most extreme cruelty and oppression occur on the part of those who exercise the prerogatives of governance. The myth of the state, as Ernst Cassirer (1946) has indicated, will yield recourse to social magic and to the drama of the magician's rituals unless people in democratic societies are prepared to extend their inquiries about human institutions to the institutions of government and learn how to specify the appropriate terms and conditions so that authority can be exercised on behalf of their shared interests, but subject to limits consistent with the proper exercise of a public trust.

When conditions in the habitual routines of daily life are raised to a level of critical awareness so that essential distinctions, specifications, and relationships yield theories of human institutions, and such theories generate critical discourses about institutional analysis and design, we have circumstances where the organization of human societies is amenable to "reflection and choice." Processes of governance and processes of making decisions about the institutions of human governance might then be organized to facilitate the use of "reflection and choice" in human affairs rather than placing primary reliance upon "accident and force."

It is in this context that Montesquieu's principle of using power to check power in the context of Madisons's opposite and rival interests can be viewed as the foundations not for stalemate and war but as occasions for people to come together and explore the underlying community of interests that is shared by opposite and rival interests. When the fundamental structure of interdependencies that generate opposite and rival interests is raised to a level of critical awareness, human beings have the potential for coming to a level of understanding about how their particular interests relate to the interests of others, and how their interdependence of interests relate to their shared public interests.

Life in democratic societies is grounded in a faith that particular interests, if properly understood, are compatible with public interests and that shared communities of interest are the proper foundations of human societies. Where the rule-constrained exercise of power is used to check rule-constrained power, human beings can come to a resolution of how to relate to others in properly constituted communities of interest so that power is shared among the diverse interests that constitute larger communities of interests. Conflict provides the energy that drives the use of human intelligence toward resolution. It is conflict and the quest for conflict resolution that enables human beings to transcend what is and to consider what might be. We can but inquire, explore, attempt to understand, in light of contestation, and then to engage in social experiments grounded in rules of just conduct and critically informed by reflection and choice.

Shared communities of understanding that provide the foundation for extended chains of actions characteristic of modern society depend upon translating the world of experience into symbolistic representations articulated in language and then using those symbolic representations to reconstitute the reality of social experience. *The translation of experience into theoretical knowledge, and the use of theoretical knowledge to alter the relationships that are constitutive of experience, are integral aspects of human cultural evolution.* Whether the course of events revealed by history yields new achievements in human cultural evolution depends in some significant degree upon the relationships of experience and knowledge to institutional analysis and design that are properly disciplined by processes of contestable argumentation, reflection, and choice that are, in turn, bounded by rules of just conduct. In some general sense, we presume that standards of truth, justice, and well-being are compatible with one another in ordering relationships in human societies. Assessments indicating conflict between values of human life do not per se contest the compatibility of standards but define situations as challenges for improvement.

37.5 The Larger Context of Inquiry

The discriminating reader will have detected at many points in this book an affinity between our approach and other methods of analysis that have a recognized place in the social science literature. The approach of this book is interdisciplinary and hence it draws heavily on contributions from disciplines ranging from law to sociology, and from economics, game theory, and moral philosophy. Our emphasis on the multiplicity of social processes of coordination and control has an important antecedent in Dahl and Lindblom's *Politics, Economics and Welfare* (1976); even though our analysis of specific modes of coordination (for example, in Chapters 18 (Gretschmann) and 19 (Hegner) on solidarity), and in the chapters of Part 5 on coordination in interorganizational relationships goes considerably beyond the scope of their treatment.

Similarly, our interest in processes of mutual adjustment and social interaction owes much to such works as Michael Polanyi's *The Logic of Liberty* and Lindblom's *The Intelligence of Democracy*. However, we stress the fact that interactive problem solving always presupposes some shared meaning and common rules, i.e.,

elements that set the context of particular action situations. The theory of public choice, and the market-failure, the bureaucratic-failure, and the government-failure literature are other important antecedents for many of the issues discussed in the preceding chapters.

Perhaps the most pervasive influence on the present work is that of the new institutional economics, and in particular of the transaction costs or "organizational failures" approach associated with Armen Alchian, James Buchanan, Ronald Coase, Mancur Olson, Gordon Tullock, and Oliver Williamson. Market failure is only a special, albeit important, case of institutional failure. If it is advantageous, under some circumstances, to shift transactions from the market to hierarchical organization; the reverse movement can also advantageously take place. Hence, markets and hierarchies are alternative methods for carrying out related sets of transactions. The reasons for organizing some transactions internally, by administrative methods, rather than across markets, by sales contracts, have ultimately to do with uncertainty and differential costs of negotiating, writing, executing, and policing contracts.

The key behavioral assumptions of the organizational-failure approach are bounded rationality and opportunism. The notion of bounded rationality is familiar from the writings of Herbert Simon. It relates to physical limits on the ability of individuals to receive, store, retrieve, and process information, as well as to linguistic limits on the ability of individuals to articulate their knowledge, experience, and preferences by the use of symbols (words, numbers, pictures) that may be unambiguously interpreted by others.

Given perfect foresight and information, it would be possible to foresee every possible contingency, and hence to draft and enforce complex sales contracts in a world of private goods and services at negligible transaction costs. However, as Williamson (1975) points out, the cognitive constraints set by bounded rationality are binding only if the environment exhibits a high degree of uncertainty and complexity. The same point can be put in different terms. The price system has considerable advantages over other institutional arrangements *provided* that the transactions are simple enough so that prices convey the needed information to all concerned parties. Obviously, this condition does not always hold. In many human services, for example, information is asymmetrically distributed between supplier and user (doctor and patient, teacher and student, social worker and welfare recipient); outcomes are ambiguous; and the nature of the transactions is such as to involve hard-to-measure aspects of quality, trust, and confidentiality. In such cases price signals do not carry sufficient information, and exclusive reliance on market arrangements leads to less than optimal results. Williamson neglects the universe of collective goods, common-pool resources, and common facilities that are of critical importance in the public sector. The failure of exclusion and jointness of use or consumption forecloses direct reliance upon price signals and requires other mechanisms to articulate demands, arrange supply, proportion supply to demand, and regulate patterns of use among communities of users. But, diverse options remain available.

Opportunism, as the term is used by Williamson, extends the traditional economic assumption of self-interest to include *deceitful* seeking of self-interest: withholding or distorting information, making false promises, misrepresenting

one's preferences and intentions, and so on. The assumption is not that all agents are given to opportunism, but that *some* may behave opportunistically, and that it is impossible or very costly to differentiate *ex ante* between honest and opportunistic agents, or *ex post* between honest and dishonest behavior.

From a comparative viewpoint, opportunistic behavior is an important factor in understanding why certain institutional arrangements are not viable, or are less developed than they might be on purely technical grounds: why it is difficult to get certain types of insurance, to get jobs for which one is intellectually qualified but has no acceptable school certificate to prove it, or why the presence of people who wish to sell defective products as good products will tend to drive out legitimate businesses. In these and many other similar cases, the transaction costs of distinguishing between honest and dishonest behavior tend to be high. Unless alternative institutions arise to counteract the effects of opportunism and the consequent lack of trust, transactions will be difficult and expensive, slowing down or impeding opportunities for development (the correlation between lack of trust and economic backwardness has been pointed out by E. C. Banfield (1961) and several other scholars).

Just as bounded rationality raises institutionally interesting problems in connection with a relatively high level of uncertainty or complexity, so the significance of opportunism is particularly greater when small numbers of actors can collude to exploit large numbers of others. For example, in a truly competitive market (a large-number situation, by definition) the opportunistic inclinations of some sellers will be usually checked by the competitive behavior of many other sellers. Collusions, cartels, and other secret agreements for deceitful purposes are, in general, viable only under conditions where small numbers of sellers can exploit large numbers of buyers.

Because relationships among members of an organization tend to be more frequent and long-lasting than market relations, opportunistic behavior is more easily exposed and subjected to sanctions. Internal auditing and control can rely on more extensive information (e.g., on quality of inputs and on production processes) than is usually available in market transactions (cf. Arvidsson: Ch.30; Grunow: Ch.31; Arvidsson and Sigg: Ch.34). Again, the benefits gained by opportunistic behavior may not be so easily and fully appropriated by the employees of an organization as they are by independent agents in a market. Problems still remain in monitoring performance to constrain that form of opportunism that Alchian and Demsetz (1972) have identified as shirking, i.e., the appropriation of on-the-job leisure. Information asymmetries in large-scale bureaucracies may yield systematic filtering and distortion of information that increases proneness to error and shortcomings in performance (Tullock 1965).

Compared to the organizational failures framework outlined here, our approach reveals important similarities as well as significant differences. Like Coase, Simon, Tullock, and Williamson, we appreciate the enormous significance of bounded rationality for the *genesis* and *modus operandi* of social institutions. We also stress that cognitive constraints become especially binding in situations of uncertainty and complexity. In the public sector this means an extensive division of labor among governmental, semi-public, and private actors, long chains of actions, and a multiplicity of more or less loosely coupled networks. Finally, as our extensive

discussion of methods of internal coordination, control, and evaluation shows, we agree that attention to internal organization is essential for understanding broader, system-wide questions of structure, guidance, and performance.

On the other hand, we believe that the minimization of transaction costs, while obviously important, is not a decisive criterion for choosing among alternative institutional arrangements in the public sector. In the conditions prevailing here, *the capacity to learn from one's own actions seems to us to be much more important than trying to specify least-cost decisional structures in advance.* Hence, the behavioral assumption of bounded rationality is expanded to include subjective limitations on memory and attention, and especially, instability of preferences. Correspondingly, the environment is characterized not only in terms of this uncertainty/complexity but also of structural and transactional features (e.g., recurrent vs. one-time exchanges) that may facilitate or impede learning (cf. Kaufmann Ch. 10) in relation to a range of goods and services that do not carry specifiable price tags (cf. Ostrom: Ch. 23).

The second behavioral assumption of the organizational failures model – opportunism – plays a relatively minor role in our discussion (but see van Gunsteren: Ch. 14 and Wirth: Ch. 29). This should not be taken to imply that, in our opinion, opportunistic behavior is not a serious problem in organizations and in the relationships between citizens and officials. The very asymmetry of roles between principals and agents, superiors and subordinates, rulers and ruled in a polity or hierarchically structured organization, produces conflicts and hence, powerful incentives to follow opportunistic and "suboptimizing" strategies. The few can easily collude within the structure of governmental institutions to exploit the many. We recognize this, but at the same time we point out that solidarity, trust, and "sympathy" in the sense of Adam Smith's *Theory of Moral Sentiments* (cf. Kaufmann 1984) are crucial for productive social interaction and a necessary basis for enduring social arrangements. For this reason, we have chosen to devote more attention to an exploration of the capabilities and limitations of solidarity as an alternative mode of guidance and control (cf. Chs. 18, 19 by Gretschmann and Hegner). That our emphasis on solidarity is a necessary complement to the study of the organizational and social implications of opportunism, rather than an alternative behavioral hypothesis this is shown by the fact that transaction-cost economists have recently begun to recognize the importance of factors like the valuation humans place on dignity and "due process" (cf. Williamson 1983). The problem is how to extend the bonds of trust to larger communities of relationships and avoid the perverse forms of "solidarity" that arise among the few who collude to exploit the many.

Despite these newer concerns, the organizational failures approach remains rather narrowly focused on economic efficiency, measured in terms of the transaction-cost criterion. On the other hand, broader issues of citizen participation, quality evaluation, and loyalty play a key role in Hirschman's *Exit, Voice, and Loyalty*. Not surprisingly the influence of the exit-voice framework is apparent in a number of chapters of the present book. While Hirschman's approach does not lead to a definite prescription for some optimal mix of exit and voice (and it is unlikely that one could specify an efficient mix of the two that would be stable over time), it does show that it is possible to determine, at any given time, whether there

is a deficiency of one or the other of the two modes of response to quality decline. This is very much in the spirit of the present work which is directed to make the reader sensitive for situations of imbalance or poor fit among different methods of coordination and control, rather than to advocate some allegedly optimal combinations.

Our efforts go beyond concerns with exit, voice, and loyalty within the confines of existing institutional arrangements and begin to explore questions of how alternative types of institutional arrangements affect opportunities for the articulation of demand through both voice and exit. Perhaps the most important opportunity for the exercise of voice in human societies pertains to institutional analysis and design, and the critical assessment of performance through alternative institutional arrangements.

As we extend the range of our inquiry into problems of institutional analysis and design, the relationship of the modes of inquiry being developed in the new institutional economics, public choice theory and game theory (cf. Shubik Ch. 28) suggest a close kinship to scholarship in the German traditions of "*Ordnungstheorie*" and the Austrian traditions of political economy. *Ordnungstheorie* has focused predominantly upon the comparative study of economic systems as being embedded in different institutional systems, K. Paul Hensel (1972: 9), for example, observes that, "The order in which we live are the foundations of our existence and way of life." The conditions of those order, Hensel suggests, determine the way that social relationships are organized in human societies. He concludes in the opening paragraph of his foreword with the observation: "The imperative of political education is to be acquainted with the possible orders, gain the clearest picture of them, and how they condition, influence, and imprint different patterns in our lives" (Hensel 1972: 9). Scholars in the *Ordnungstheorie* tradition are drawing both upon the earlier traditions of German institutionalism and the new institutional economics to extend their understanding of economic orders as ways of life (Schüller 1983). Our efforts have been to extend the type of inquiries pursued by scholars in *Ordnungstheorie* to an explicit consideration of the public sector.

At the same time, contemporary scholars in the new institutional economics and public choice traditions, like Bruno Frey (1982), are indicating the importance of recognizing the earlier contributions of J. A. Schumpeter and other scholars, like F. A. Hayek, in the Austrian traditions of political economy. Other European traditions in economics, jurisprudence, philosophy, political theory, and sociology as reflected in the works of Cassirer, Durkheim, Luhmann, Pareto, K. Polanyi, M. Polanyi, Popper, and M. Weber help set the frame for many of our efforts.

As we extend our reflections about the study of human institutions, it becomes apparent that Europe has maintained a multidisciplinary and multinational community of scholarship from the enlightenment to the present which is concerned with the nature and constitution of order in human societies. Hobbes, Rousseau, Montesquieu, Hume, Smith, Kant, Hegel, Tocqueville, Marx, and many others all make their potential contributions to a continuing inquiry about problems associated with the nature of order in human societies. Contending arguments and potential contradictions abound in many of these formulations. Many different levels of analysis are implicated. Too often words have been used pejoratively to

war upon one another. The task of fashioning contestable arguments that can be translated into a common language of discourse remains as a challenge to enlightened discourse. The use of theory to design new institutions and to transform societies has occurred in one form or another among all of the countries of Europe and North America. We, in this volume, have variously drawn upon different traditions of social theory, social science research, and social experience; but we have also tried to repay our debts by contributing to the continuity of that multidisciplinary, multinational community of scholars concerned with the nature and constitution of order in human societies.

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