

# Michał Możdżeń

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## To what extent do some fundamental concepts of New Institutional Economics help explain the governance phenomenon?

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Michał Mozdzeń

## To what extent do some fundamental concepts of New Institutional Economics help explain the governance phenomenon?<sup>1</sup>

The paper is an attempt to describe synthetically the relationship between the New Institutional Economics theory and the problem of governance research. The undertaking requires, without doubt, an in-depth research and extensive analysis, taking into account the various concepts developed by New Institutional Economics, and above all used to analyze the phenomenon of governance. Of necessity, the present paper is a far incomplete analysis of the problem, but allows one to present the basic commonalities and differences between the logic of economic analysis and its subject – which in this case is governance. For the purpose of this text, we define governance in accordance with the model of network governance as put forward by Leach et al. (2007)

Keywords: New Institutional Economics, governance, networks, Transaction-cost Economics, principal-agent relationship, political institutions.

### Introduction

The problem of governance is described, in particular by political scientists, as one of the approaches to coordination of social action, along with hierarchy and market, or order and exchange (Jessop 2007). It is a manner of social coordination that involves a specific attitude to the problem of social action – it does not identify definitely the relationship of power or economic exchange, but can be simultaneously considered in line with the broader paradigm of social exchange (Homans 1967). In this regard, it is worth looking at opportunities to explain the phenomenon of governance using the models developed for economics. In particular, it seems worthwhile to look at governance through the prism of New

Institutional Economics (NIE), which allows one to treat governance as an institutionally determined model of interdependent activities of individuals, and to reflect on the conditions under which this particular method of coordination can be more successful in comparison to the market or hierarchy. To facilitate the task of linking the two phenomena – NIE and governance – the latter is defined strictly as governance networks, characterized by:

1. Multitude of actors, blurring borders, network interactions between different levels of action, the multiplicity of spaces of activities,
2. Authority which is widely spread and fragmented, materialized in action within the network,
3. Many interactions and contingencies in the political process, which lead to uncertainties in the process of governance and with respect to the results of governing in connection with the problems of dynamics and uncertainty (Leach et. al. 2007).

The text is divided into four parts:

In the first part, New Institutional Economics is compared to the so-called old institutionalism developed since the early-twentieth century.

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Michał Mozdzeń – Cracow University of Economics, Department of Public Economy and Administration.

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Here the basic constitutive elements of NIE are presented and a definition is proposed.

The second part is the principal one in the paper. Three fundamental theories within the perspective of New Institutional Economics are presented: transaction-cost economics, the theory of principal-agent relationships and the theory of management of the commons. The substantive and methodological relationship between each theory and the concept of governance is proposed.

Taking into account the differences in research perspectives of New Institutional Economics and those which underlie the traditional analysis of the concept of governance, the third part attempts to present synthetically the identified problems that might be encountered in integrating both perspectives.

In the fourth part, basic conclusions stemming from partial analyses are drawn.

The general hypothesis of the text is that New Institutional Economics can constitute a very useful tool for explaining some of the issues of network governance, however, this tool remains underdeveloped and needs to be carefully refined for this purpose. At the same time, no particular theory within NIE research allows us to assess comprehensively governance institutions, and, for this assessment, one needs to treat them as complementary to each other.

## **1. New Institutional Economics – relationships with “old institutionalism” and a definition of institution**

For at least 20 years, NIE has remained one of the most promising directions of development in economic theory and research. In the context of fundamental critique of mainstream economics as a result of the crisis events at the end of the first decade of the 21<sup>st</sup> century, the development of NIE is observed closely by researchers seeking new paradigms that can help answer key social questions. Among these questions are the following: How to shape a market that is likely to stimulate economic growth without deepening inequalities? What institutions are appropriate for countries at different levels of development? What kind of institutional rules allow us to maintain a balance between market, state, and

civil society? Finally, what seems to be the most important from the point of view of the problems of governance, what institutional arrangements allow the inclusion of citizens in the processes of governing in a deeper and more systematic way than the traditional representative democracy?

New Institutional Economics is a trend that grew out of two parallel currents within economic thought. The first one seeks inspiration in the achievements of traditional institutionalists, whose interdisciplinary work on the borderline of sociology, economics, and anthropology emerged in the late 19<sup>th</sup> and early 20<sup>th</sup> century. It includes Thorstein Veblen's, John Commons' and Max Weber's works. The second trend is related to the work of unorthodox economists formed in the second half of the 20<sup>th</sup> century, who pointed to the role of the market rules of the game in mitigating problems of externalities and transaction costs in the economy (R. Coase, O. Williamson). In later years, institutional analysis also covered the problems of management of the commons (G. Hardin, E. Ostrom).

Traditional institutionalists and the representatives of NIE share both the interdisciplinary approach and the object of study. These are the “*rules in action*” (Commons 1931) which are indicators of activities of social actors. To some extent, however, what differentiates these approaches is the way institutions are explained. According to the representatives of NIE, institutions are primarily restrictions imposed on actors behaving purposefully and rationally, allowing them (or not) to reconcile public interests and to minimize (or not) the transaction costs that hinder reaching multilaterally beneficial agreements, both in the market and in other spheres of human interaction.

Traditional institutionalists understood institutions more broadly – less as barriers, and more in terms of signposts to help individuals who do not have full information about the consequences of their actions make decisions without incurring excessive costs of acquiring information and in accordance with social expectations. This way of understanding the institution is now more common among representatives of institutionalism within political science (March, Olsen 1989).

When it comes to classical institutionalism, perhaps the clearest definition of the institution

(further broken down by social and economic institutions) can be found in T. Veblen (2008, p. 125, 128):

Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; (...) These institutions are habitual methods of carrying on the life process of the community in contact with the material environment in which it lives

As it turns out, the definition offered by the representatives of NIE does not differ completely from those suggested by the traditional institutionalists. In the words of Douglas North (1990, p. 3):

Institutions are the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic.

It should be added that as a researcher, North is primarily interested in economic institutions, but it seems that this definition can also be conditionally applied to political institutions (see Menard, Shirley 2008). In the above quotations, the difference in understanding the institution, which has been pointed out above, can be easily perceived. Traditional institutionalists, when defining institutions, usually refer to “habits”. Representatives of NIE usually prefer to speak of “constraints”.

NIE is different from classical institutionalism because it builds primarily on orthodox economics, adding and changing its assumptions to allow it to connect to the institutional thought. In particular, NIE rejects the standard neoclassical assumption of full information and unbounded rationality of actors, and that transactions take place immediately, at no cost. In terms of NIE, people have incomplete information and limited cognitive abilities and therefore need to cope with uncertainty about unforeseen events and incur costs of transacting and acquiring information.

To reduce this uncertainty and transaction costs, people create institutions, design and enforce law, contracts and regulations (formal institutions), as well as cultivate norms of behaviour, beliefs,

and habits of thought and behaviour (informal institutions). On the basis of such structured formal and informal institutions, different methods of organizing activities arise which provide different incentives, motivating to varying degrees the affected actors. For the representatives of this approach, the effectiveness of a market economy depends on formal and informal institutions, organizations that emerge within them, and their joint impact on facilitating trade and encouraging cooperative actions.

In this regard, institutions are, however, not treated merely as instruments of rational minimization of transaction costs and negative externalities but (like in sociological institutionalism) are created and recreated endogenously through (1) path dependence (Pierson 2000), (2) complex adaptation (Ostrom 1999), (3) critical junctures (Acemoglu, Robinson 2012).

- 1) The first concept indicates that the path of institutional changes, due to the phenomenon of rising alternative social costs of radical institutional changes, goes through incremental modification or expansion of existing social norms. That is why it is so difficult to expect in a given society revolutionary systemic changes that essentially rearrange a specific institutional landscape.
- 2) The second approach is more strongly associated with theories of social evolution. Their supporters point to the role of the changing external environment in shaping the social rules and systemic processes of learning by trial and error, which leads to continuous selection of better-performing institutional configurations.
- 3) The third group of theories on institutional change consider the role of external events that destabilize the development of the social system and allow for its thorough reconstruction, though not always lead to that goal (they are conditions *sine qua non*). These types of events can take the form of social revolutions, wars and economic crises that destabilize the relative institutional balance within the system, giving impetus for a creative institutional destruction.

On the issue of endogeneity of institutions within social systems, as well as on taking account of moral and normative considerations of the effects of various institutions, NIE seems to be positioned closer to the sociological institutional-

lism than to mainstream economic thought. Overall, the method of institutional analysis as an extensive programme of research seems to be very useful in explaining all phenomena relating to social actions, including the practices of public governance, especially network governance.

## 2. The input of NIE in the development of public governance discourse

### 2.1. Transaction-cost economics

Transaction Cost Economics (TCE) is one of the cornerstones of New Institutional Economics. It is also important for the understanding of the benefits and costs of different approaches to structuring public governance. Launched in 1937, with Ronald Coase's provocative question, "Why do firms exist?" (Coase 1937), it is a theory aimed to explain the existence of different organizational and institutional structures in relation to the degree of achievement of the basic social goal – a reduction in the costs of social action coordination.

Transaction costs associated with social activities can manifest in various forms:

- The costs of negotiations in the presence of conflicting interests: *the price system is a very expensive system. If you stop and think about all the things that you need to know to make a transaction, it becomes obvious that this is not a cheap system. And a system that avoids negotiation is a system that saves much costs* (Coase 2012).
- The costs of coordinating collective action (common goods, public goods),
- The costs of enforcing the desired behaviour and the costs of ensuring the observance of contracts,
- The costs of exploration and acquisition of information (Dahlman 1979).

In the tradition of the work of O. Williamson, the reasons for the emergence of transaction costs can be traced back to several situations: the occurrence of mutual dependence, varying specificity of resources and processes of resource creation, the uncertainty of relations and results, risk of partners dishonesty. All these elements are to some extent focused on the concept of H. Simon's "bounded rationality" the proponents

of the theory of transaction costs often refer to, and on the related problem of "incomplete contracts".

The discussed theory is traditionally used to analyze the institutions that govern purely economic relationships, or in other words, market institutions. The concept of transaction costs is also central in law and economics, which focus on its practical application, particularly by judges working in the area of common law.

However, it is increasingly perceived that this universal theory can be a convenient supplement to analyses of decision-making and action in the political sphere, starting with the question "why does the state exist?" and ending with the question "how to design a system for making and implementing policy decisions in the sphere of e.g. forest management to minimize the costs of its operation?".

The basic concept around which the analyses within the transaction cost theory are built is the phenomenon of contract, and especially contract incompleteness. The second term indicates that the impossibility to include all material elements of an agreement within a contract is fundamentally related to the inherent risk of abuse of contractual arrangements by one of the parties (Williamson 2010).

The problem of contract negotiations is related to the concept of contract in the formulation of public policies, or simply put, to the cost of the decision-making mechanism, which, as already indicated by Condorcet, but also by Arrow (1951) and Buchanan and Tullock (1962) tend to grow rapidly with the number of actors involved in the decision making process.<sup>2</sup>

In basic economic terms proposed by Williamson, the transaction cost theory is concerned with the reasons for "make-or-buy" business decisions (should a specific good be made within the company or purchased on the market). For these reasons, the researcher looks in the concept of asset specificity, assuming that the less standardized the good, the greater the tendency to manufacture it in house instead of searching for it using the market mechanism. It is therefore, fundamentally, a theory contrasting market solutions to

<sup>2</sup> In these analyses, the decision making cost is unavoidable if we want to minimize negative externalities of any particular social decision.

hierarchical solutions in accordance with Coase's fundamental question, quoted above.

Nowadays, taking into consideration the widespread adoption of the third fundamental form of the establishment of alliances and decision making, i.e. the network (Amin, Hausner 1997), it is recognized that TCE is a good basis for the assessment of institutional solutions also in this sphere (Tang, Mazmanian, Zhan 2011). From the point of view of comparative analysis of transaction costs of actions undertaken by predominantly public organizations, a question can no longer be formulated in the form of a simple "make-or-buy" dichotomy. Instead it should take into account the specific nature of the decision-making process, along with the question regarding the degree of integration of external stakeholders into the decision-making networks. It should also consider the nature of decision implementation on the basis of three different forms of coordination of collective action – hierarchy, market and network (ibid). In addition, Williamson himself notes that basing a decision on the resource specificity is not enough, especially when we analyze the problems of the public sphere. These characteristics should be supplemented by problems of probity and credible commitments, and it is necessary to include them all in the decisions on activating different coordination mechanisms (Williamson 1999).

In addition, in the public sphere, which increasingly encounters complex and multi-dimensional problems, decision-making processes are characterized by inherent uncertainty and deficient information. So nowadays it is recognized that the decisions taken by means of a network, or integrating multiple stakeholders, allow, under certain conditions, to minimize transaction costs in a situation of high uncertainty, and a low level of information on the consequences of undertaken steps (Jones, Hesterly, Borgatti 1997).

Williamson's traditional approach does not take into account the network (basic category of governance) as an entirely alternative mechanism for the coordination of collective action. However, it recognizes the existence of the so-called "hybrid" or "mixed" solutions, which can be approximately regarded as including network mechanisms. Actually, Williamson acknowledges in his later works that their occurrence is more common

than he once anticipated (Williamson 1985). As Hardt (2008, p. 126-127) emphasizes: *One of the most important forms of hybrid management is the organization of specific transactions between entities maintaining their independence with credible commitments.* As we can see, the basic characteristics of the hybrid solutions are largely consistent with the characteristics of network solutions, although e.g. Ruitter, in an analysis of the public sphere, equates hybrid solutions with state regulation of market activities as opposed to full privatization (markets) and full nationalization (hierarchy – Ruitter 2005).

Hierarchy and market are at the two opposite extremes as methods of coordination of collective action. Each of them is supported and defined by different forms of contract law: in the case of markets, contracts are phrased explicitly, while they are implicit in hierarchical systems. The second difference between these methods is the way of adaptation: in the case of markets, adaptation is spontaneous, while within hierarchical structures, it is controlled (intentional). Furthermore, while markets are more dependent on incentivizing instruments, organizations use forms of administrative control (Williamson 1996).

The specific, hybrid form of coordination includes network configurations, but can also be applied to a single organization. Hybrids are governed by forms of contract specific only for them, which take into account the relative "narrowness" of network with comparison to markets, and a relatively small number of players that form strong, long-term relationships, where reputation remains a very important issue (Gijsbers 2001).

The transaction cost theory also explains why mechanisms of network governance are used primarily in the decision making process, and much less in the implementation phase. To develop a framework for implementation (public policies design), knowledge distributed among different actors who negotiate the final shape of the decision is often necessary. In this case, to ask whether it is rational to utilize network governance tools implies referring to the costs of decision-making and the benefits of obtaining consent from a negotiation partner (thereby minimizing external effects of political decisions).

However, since appropriate institutional arrangements that facilitate the enforcement of the desired behaviour in the implementation phase within the network are scarce, especially if it is difficult to estimate a medium of exchange and if there are problems with honesty and delayed reciprocity, it is better to use a hierarchy or the market for the supply of a given good or service. In other words, it seems difficult to encourage proper behaviour in network partners without using administrative or civil law.

In conclusion, it should be noted that the great advantage of TCE is its emphasis on the comparative evaluation of different institutional arrangements depending on the extent to which they mitigate the problem of transaction costs, taking into account the nature of exchanged goods or undertaken decisions. At the same time, it seems that the approach has not yet been adequately translated into the language of economics of the public sector, which no doubt requires more explicit inclusion of the issues of trust and the cost of deliberation into the determinants of transaction costs.

## 2.2. The principal-agent theory

The principal-agent theory, also often termed the agency theory, is now one of the most explored research trends in the framework of Transaction Cost Economics. The origins of the theory can also be found in the pioneering work of Coase (1937), who was one of the first mainstream economists who gave a glimpse into the inner workings of organizations, making it possible to treat them as a kind of a “nexus of contracts”. The principal-agent theory constitutes another framework (similarly to transaction-cost economics), which is based on the observation of “bounded rationality” formulated by H. Simon (1947).

The theoretical basis of the concept, however, is richer and above all includes the problem of “information asymmetry” between the partners of the contract and its basic consequences:

- Moral hazard (which can be explained in terms of making use of the information advantage to abuse the provisions of the contract by an agent – e.g. Arrow 1970 describes a situation in the health insurance market, where insurance

policy holders hide information on the actual health risks of an insurer),

- Adverse selection constituting a natural response to the problem of information asymmetry and involving the rejection of potentially profitable contracts to protect oneself against the abuse of an agent,
- Hold-up problem, in which both parties, despite the fact that it would be advantageous for both of them, decide not to cooperate for fear of loss resulting from insufficient involvement of other parties in the pursuit of common purpose, and the resulting consequences of incurring relatively higher costs (Williamson 1979). The hold-up problem leads to abstaining from setting up potentially beneficial mutual cooperation.

Probably the most common definition of a principal-agent relationship is the one proposed by Jensen and Meckling: *a contract relationship in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent* (Jensen, Meckling 1976, p. 306).

The agency problem stems directly from the diversity of goals between the principal and the agent in the context of information asymmetry between them. Organizations struggling with this problem minimize it by developing incentive contracts, strict control mechanisms, or generating rules of conduct in a more coherent way, binding the interests of both parties to the agency relationship.

Nowadays, the agency problem has been incorporated into the analysis of the public sector with the tools of public choice theory (Shapiro 2005). In this perspective, the principles of the agency relationship are essentially analogous to the classical economic version: the principal passes to the agent the authority to make decisions and to carry out various tasks on his/her behalf. The objectives of both parties are often conflicted, and in the presence of information asymmetry, the principal may have a problem with forcing agents to act in accordance to his/her preferences.

The problem of the agency relationship is usually considered in the context of behaviour within hierarchical organizations (business, public bureaucracy), but its presence can be detected in

Table 1 The amount of information and the suitable coordination mechanism

Principal \ Agent	High amount of information	Low amount of information
High amount of information	(1) Market	(2) Hierarchy
Low amount of information	(3) Hierarchy	(4) Network

Source: own elaboration.

each of the three basic mechanisms of coordination of collective action (i.e. hierarchy, market, and network). Perceiving information asymmetry (or the cost of acquiring information) as the main distinguishing feature of the agency problem, one can attempt to create a matrix indicating the best coordination mechanism controlling transaction costs in this case, depending on the amount of available information resources and the imbalance between the parties to contract (table 1).

1. If the amount of information is high on both the principal's and the agent's side, information asymmetry does not preclude the use of contractual solutions – commercial contract, civil contract.
2. In a classical situation of information asymmetry in favour of an agent, the need for greater control often requires the use of hierarchical solutions (e.g. employment contracts, but also state surveillance).
3. If there is information asymmetry in favour of the principal, a hierarchical solution also seems to be the most effective. This is due to the risk of failure in contract execution as a consequence of the agents' ignorance of the full preferences of the principal. Therefore, it also calls for hierarchical control.
4. If there is not enough information on both sides of the agency relationship, it seems necessary to form close partnership relations in order to share the knowledge needed to solve emerging problems. In this case, the agency relationship disappears and gives way to a dialogue of equal partners sharing mutual trust.

Basically, however, it seems that in the relations of governance (network coordination) the classical problem of agency, understood as the result of information asymmetry between the principal and the agent, is very rare. This is because:

1. It is difficult to identify clearly the basic actors of the agency relationship.
2. Network relations assume the equality of partners, but often have a centre of gravity. However, this centre cannot be understood as a principal in the traditional sense.
3. Network governance refers primarily to decision-making mechanisms, while the agency relationship usually occurs between policy-makers and implementers.

An approach based on the principal-agent relationship, however, is a useful supplement to the research on the root causes of the use of different coordination mechanisms. It can also be used as a valuable framing of normative questions on the effectiveness of different mechanisms in a given situation, based on the specific nature of the problem to solve, the characteristics of various actors, and the resources they possess. In addition, the issues identified by the agency theory as moral hazard, adverse selection, or the hold-up problem can play a complementary role in explaining the inefficiency of specific governance networks.

### 2.3. Elinor Ostrom – Polycentric governance of the commons

New Institutional Economics is relatively closest to the concept of governance regimes in research on the commons' management, conducted by Elinor Ostrom. Ostrom's model combines several theoretical trends in economics, including the theory of public and rational choice, and a range of concepts in the field of NIE. As part of NIE itself, Ostrom's model may be regarded as a bridge between the rather abstract analysis of political institutions offered by North, Wallis and Weingast (2006), or Acemoglu and Robinson (2012), and

a more detailed analyses of coordination of social action, undertaken by Williamson. At the same time, the researcher's fundamental idea is the classical concept of the tragedy of the commons, first proposed by G. Hardin (1968).

Traditionally, common resources are considered as one of the four basic categories of goods next to public, private, and club goods. The specificity of this category is the difficulty of preventing anybody from their use (weak property rights) in combination with high marginal costs of utilization (only one party can use it at a time). At this point the "tragedy", to use Hardin's terms, consists in the possibility to privatize profits and communalize costs. In the language of game theory, we can talk of a situation which resembles the so-called prisoner's dilemma, in which the Nash equilibrium (rational response of independently acting actors)<sup>3</sup> does not simultaneously generate a Pareto-optimal situation (i.e. one in which it is not possible to improve the position of one of the partners without deteriorating the situation of at least one of the other partners). In other words, cooperation of actors using shared resources is "optimal", but very unstable.<sup>4</sup>

Researchers describing the problem of common resources in Hardin's tradition, recognize that the only way to counter such a situation is through imperious actions of the state (**hierarchical management**) that will take over ownership of the commons and will force the entities who share it to use it efficiently (a classic example are limits of marine fishing imposed on fishermen).

Other economists, referring to a concept called the Coase theorem, pointed to the privatization of a common resource (use of the market mechanism) in order to assign unambiguously property rights to it (see Coase 1959). This makes it possible, in their opinion, to assume correspondingly low transaction costs, a socially favourable construction of the mechanism of utilization of such goods.

According to Ostrom, who supports her arguments with lifelong studies, although sometimes the mechanisms can be used for the management

of common resources, the rationale for them is at least debatable, because: first, at the theoretical level, a model of full rationality, which generates a simple version of the prisoner's dilemma, can be sometimes useful in explaining market activities, characterized by competition, conflict of interest, and a short time horizon, but in the case of many social dilemmas, often with complex repeated games, interdependencies between actors and their limited rationality require a more nuanced, dynamic approach (Ostrom 1997). Second, at the empirical level, it turns out that in many situations the commons are managed in a way that ignores hierarchical and market methods, and uses social reciprocal mechanisms. What is more, it is often the method of coordinating social action which brings the most positive results (Ostrom 1990).

In view of this – and taking into account the existence of a multitude of polycentric orders in the social world which are characterized by overlapping sources of authority and legitimacy, and the complexity of the relationship between the participants of social life – Ostrom concludes that the state-market dichotomy must be rejected as inadequate, and recognizes the multiplicity of forms of social action coordination processes (Lund 2001). At the same time, we should not forget the fundamentally dynamic nature of social phenomena, and we should emphasize the issues of social evolution and adaptation, knowledge, learning and experimentation, rather than the static concept of structure, balance and unchanging behavioural assumptions describing an entity in action. The role of institutions in this approach is to organize the flow of new knowledge and its transmission in order to simplify the decision situation (Aligica, Boettke 2010).

Ostrom assumes that there are three groups of factors influencing the situation of collective action which allow us to determine the effective mechanisms and rules of social interaction: 1) The initial mental models and internalized heuristics, norms and rules, 2) Group properties (size, diversity, communication capabilities, power relations and leadership, past experience of cooperation, shared belief in a common goal of action), 3) Properties of the resource which is being managed (its scarcity, predictability, the function of production and distribution, the nature of property rights, mobility, etc.) (Ostrom 2003).

<sup>3</sup> At least in a one-off game (see Axelrod, Hamilton 1981).

<sup>4</sup> In the economic sense, this resembles a situation of a price cartel, which should maximize profits of all colluding partners. At the same time, every one of them has an incentive to break the cartel independently.

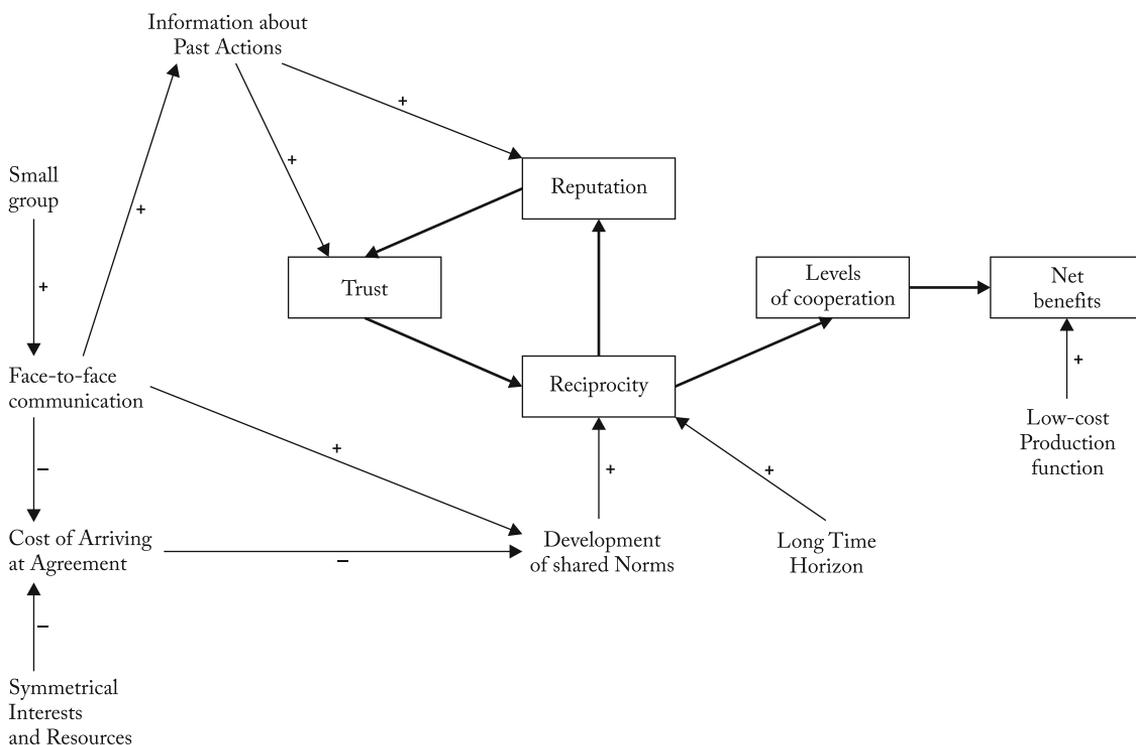


Figure 1 Model of the logic of cooperation in the governance process

Source: Ostrom 1997.

According to Ostrom, it is generally favourable to take action with the use of a network when a group is relatively small, the goods being managed have a local character, communication is not difficult, and especially when individuals have social capital in the form of mutual trust, understood as a subjective belief in the reciprocity of partners (Ostrom, Ahn 2007).

To illustrate this mechanism, a following diagram (Figure 1) can be used.

The basic mechanism involves mutually reinforcing characteristics of the members of the group: trust, reciprocity, and reputation, which increase the level of resulting cooperation and benefits. The smaller the group, and the better their communication, the lower the cost of making decisions, but at the same time low cost of making a decision weakens the mechanism of construction and internalization of shared norms, which may adversely affect the principle of reciprocity. At the same time, face-to-face communication directly affects the development of shared norms and the

knowledge of past actions, which enhances the effect of the basic mechanism. In addition, the longer the horizon of action, the stronger the norm of reciprocity.

On this basis, we can see that network governance is difficult in larger groups, but institutions inviting unconstrained communication and, more broadly, lowering transaction costs of the decision-making process, give the opportunity to generate a sustainable network also at higher levels of government. This model, however, clearly shows why public governance occurs more frequently at the local government level than at the central level.

On this basis, Ostrom builds the concept of common resources governance, which includes the framework of basic system rules that structure the shape of coordination mechanism. In the analysis, and above all, in setting up institutions suitable for a given problem (in addition to its intrinsic characteristics) one should then take into account seven categories of rules:

1. Position rules – determining what positions will be highlighted in the structure of the group,
2. Boundary rules – describing the selection of members of the group,
3. Scope rules – defining a set of outcomes and associated benefits/costs,
4. Choice rules – assigning specific possible actions to particular positions,
5. Aggregation rules – constituting the decision function,
6. Information rules – defining channels and a language for communication,
7. Payoff rules – defining the distribution of benefits and costs of the action group (Ostrom 2000).

Hoffman and Ireland (2013) graphically show how the above rules structure an action situation (Figure 2).

On this basis we can try to analyze how different categories of rules behave in three basic mechanisms of coordination. Table 2 presents them.

Ostrom indicates that imperative government underestimates the diversity and adaptability of axiological entities that are able to make their own efforts to achieve their long-term interests. Instead, it should treat its citizens as active and support them by offering institutions which reduce the cost of interaction and activity (although she rather means an activity in which the state is not one of the actors but only an enforcer of the rules). She formulates eight properties that characterize institutions offering effective sustainable solution of social dilemmas:

1. Clear definition of the use boundaries and the possibility of withdrawing from the use of goods,

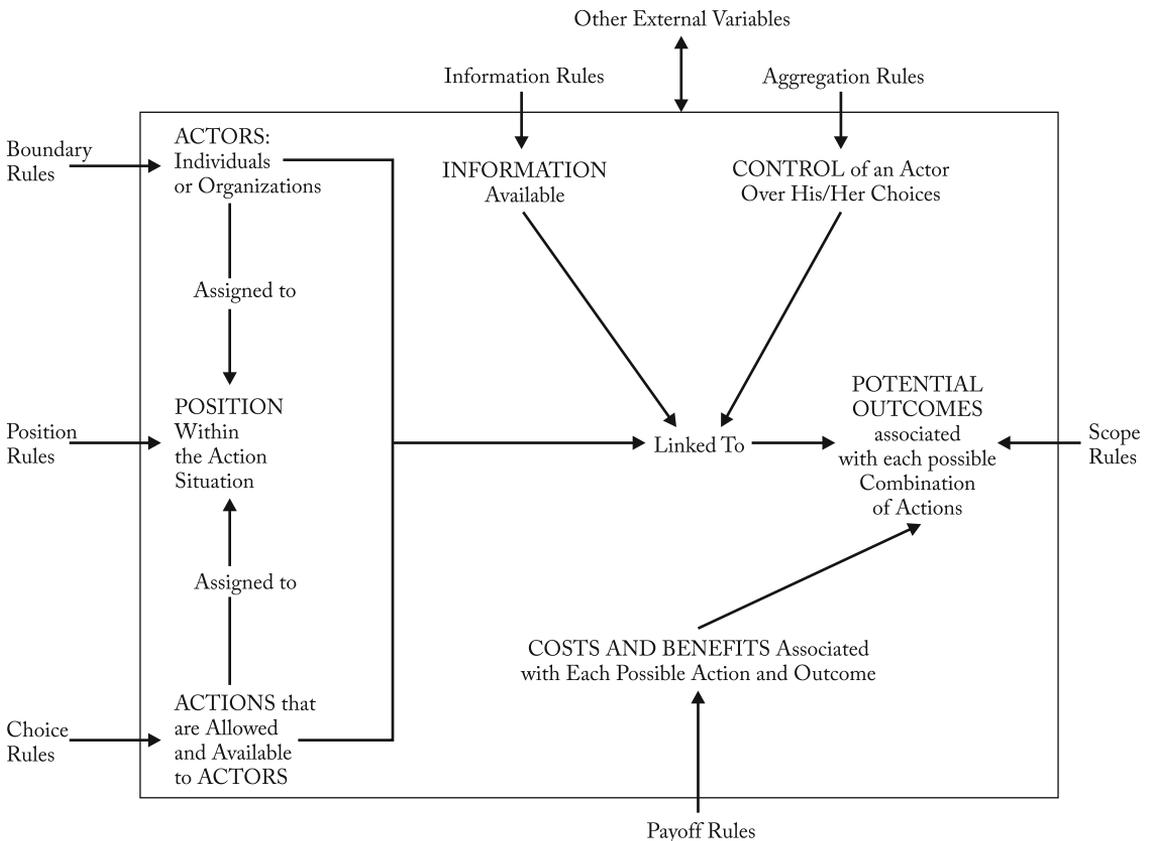


Figure 2 The internal structure of an action situation

Source: Hoffman and Ireland (2013).

Table 2 Rules for the common resources governance and social action coordination mechanisms

Mechanism	Hierarchy	Market	Networks
Position rules	One strong centre, vertical alignment of positions	Symmetrical relations	Quasi-symmetrical relations, hybrid solutions
Boundary rules	Entry based on the ability to fill programmed functions. Low turnover	Low barriers to entry, verification through the ability to fulfil specific functions (monetary aspect), high turnover	Entry and verification based on the ability to cooperate and build trust in the group. Low turnover
Scope rules	Standardized results, benefits related to the strengthening of structure legitimacy – short- to medium-term frame of reference	Non-standardized results, monetary and utilitarian benefits – rather short-term frame of reference	Non-standardized results, benefits of strengthening the process of cooperation and sustainable use – rather long-term frame of reference
Choice rules	Range of possible choice depends on the place in the hierarchy	Range of possible choice depends on the ability to serve utilitarian needs	Range of possible choice depends on trust, reputation, and respect
Aggregation rules	Decisions made in a small group	Decisions made in a distributed manner	Decisions made collectively
Information rules	Formal language, information obtained mainly from within the structure	The main source of information is the environment – price and available technologies	Internal and external sources of information. Common language. The presence of feedback loops between the action and the reaction of the environment
Payoff rules	Payoff decisions made by leadership, division of benefits generally dependent on the position in the hierarchy	Payoffs in principle depend on the degree of fulfilment of utilitarian needs	Payoffs rather even, differentiation dependent on the reputation and contribution to the operation of the network

Source: own elaboration based on Ostrom (2000).

2. Congruence with conditions, for the use of common resources according to local rules,
3. Collective decisions about the shape of decision institutions,
4. Execution of rules subject to collective control,
5. Use of graduated sanctions,
6. Access to efficient, effective conflict resolution mechanisms,
7. Recognition of the right to self-organization of the group by local or national authorities,
8. For more resources – creating multilevel, nested institutions.

Taking into consideration the possibility of building systems of coordination of collective action, based on the mechanism of public governance, the concept of Ostrom is at the same time encouraging and rising concerns. Encouraging, as it indicates how network governance can func-

tion effectively and produce positive results. Rising concerns, because most of the positive outcomes of such a mechanism can be found in small communities struggling with well-defined problems. However, it seems that the process of continuously lowering transaction costs of network coordination, combined with slowly increasing transparency of public action, expands the scope for experimentation with such solutions on a wider scale.

### 3. Limitations of New Institutional Economics in explaining public governance

New Institutional Economics offers many opportunities for creative interpretation of the

Table 3 Problems with explaining public governance by some NIE theories

Group of theories	Research problems
Transaction-cost economics	Focus on the level of individual organizations – microeconomic perspective, inadequate perception of public entities as active social actors. Attributing a marginal role to the network as an alternative mechanism of social action coordination. Focus on formal institutions and recognition of the incompleteness of contracts as a negative quality, reinforcing the uncertainty in the market and offering the opportunity to exploit these vulnerabilities by rational actors. Generally, accepting the logic of competition.
Principal-agent concept	Recognition of the central role of the information asymmetry (rather unable to explain the situation in which the asymmetry does not exist). Recognition of incompleteness of contracts as negative qualities, reinforcing the uncertainty in the market and offering the opportunity to exploit these vulnerabilities by rational actors. Generally, accepting the logic of competition.
Common resources management	Inadequate perception of public entities as active social actors. Focusing on the state as a creator and executor of formal norms. Little faith in the existence of an effective and beneficial governance mechanism at higher levels of government.

Source: own elaboration.

concept of public governance from the perspective of economic theories. However, there is little doubt that apart from Ostrom's theory and the relatively minor domain of network institutionalism (Hall 1986, Hecló 1978), NIE undoubtedly imposes some limitations on the range of explanations of the problems faced by the concept of public governance. This is so, it seems, because NIE is primarily private realm- and market-oriented (as befits an economic theory).

For each group of theories mentioned in this text, one can try to point to the shortcomings from the point of view of the problems with explaining public governance. Table 3 synthetically presents the arguments.

At the same time, however, it seems that the problems that affect the group of theories described above do not constitute inherent limitations (possibly excluding the principal-agent theory), and only need to change their research approach, recognize the existence of various forms of social coordination mechanisms, become more accepting of unrestrictive assumptions concerning the preferences of individuals and their dynamics, and more willing to integrate approaches developed within related disciplines of social sciences. New Institutional Economics, however, is still a young discipline, continuously expanding its field of interest. Therefore, without doubt, taking into account the exceptional flexibility of its as-

sumptions, in the future we will be able to watch the more adventurous excursions of NIE into the realm of public governance.

#### 4. Conclusions

This paper presents basic concepts in the context of the rapidly expanding and highly prospective economic domain of research, namely New Institutional Economics. On the one hand, its individual theories utilize similar concepts and definitions. On the other hand, however, it seems that this trend is still quite eclectic and insufficiently linked to the approaches based on the analysis of the institutional framework used by other social sciences (political science, sociology). Yet, it is a family of theories which should be monitored carefully, as it offers an effective alternative to the neoclassical approach which still seems to be dominant in economic sciences.

At the same time, we should appreciate the extraordinary potential flexibility of NIE in explaining diverse social phenomena. In particular, it is easy to see this potential while trying to bind NIE concepts with the public governance paradigm. It turns out that the theory of transaction costs, incomplete contracts, management of common resources, or agency relationship all help to explain the dynamics of network governance

Table 4 Problems with public governance and explanations offered by NIE

NIE concept	Explained problems
Transaction-cost economics	Decision-making within network, respect and enforcement of obligations, issues of trust and reciprocity.
Principal-agent concept	Terms of efficient use of governance mechanisms, the presence of information asymmetry and the possibility of using networking methods, the problem of barriers to social interaction (negative selection, the hold-up problem).
Common resources management	Conditions for the effective functioning of social networks at different levels, the catalogue of institutional rules of the decision-making mechanism. Allowing for a wide variety of axiological constitutions of individuals (non-conditional cooperation, conditional cooperation, reluctance to cooperate and so on), normative guidelines for a well-designed decision-making mechanism.

Source: own elaboration.

without risking the accusation of “economic imperialism”, which was formulated against e.g. rational choice theory of the first generation (Becker 1993). Table 4 provides a summary of the core problems associated with public governance in relation to the various concepts of NIE.

There is no doubt that the group of theories under a common label NIE does not at the moment have at its disposal an ideal methodological and conceptual toolbox to offer a comprehensive explanation of the issue of public governance. However, it can be a useful complement to the models created specifically for explanations of this phenomenon, and in the future it can form a basis for developing a comprehensive set of instruments for its analysis.

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## **Na ile nowa ekonomia instytucjonalna pozwala wyjaśnić fenomen współzarządzania?**

Tekst stanowi próbę syntetycznego opisu relacji między nurtem nowej ekonomii instytucjonalnej a problemem badawczym współzarządzania. Przedsięwzięcie takie wymaga bez wątpienia dogłębnych badań i rozbudowanego ujęcia, uwzględniającego poszczególne koncepcje wypracowane zarówno po stronie nowej ekonomii instytucjonalnej, jak i przede wszystkim w analizie fenomenu współzarządzania. Z konieczności więc niniejszy tekst ma charakter dalece niekompletnej analizy problemu, jednak pozwala na przedstawienie zasadniczych elementów wspólnych, jak i rozbieżności między logiką analizy ekonomicznej a jej przedmiotem – który w tym wypadku stanowi współzarządzanie. Rozumienie współzarządzania na potrzeby tego tekstu ograniczone jest do modelu współzarządzania sieciowego w ujęciu Leach i in. (2007).

Słowa kluczowe: nowa ekonomia instytucjonalna, współzarządzanie, sieci, ekonomia kosztów transakcyjnych, relacja mocodawca-pełnomocnik, instytucje polityczne.