2

The primary importance of distributional conflict

In giving an explanation of a social institution, either of its maintenance and stability or of its development, we focus initially on the impact of that institution on a particular aspect of social life: the difference that the existence of the institution makes for social interactions. This "impact" may be called an effect, a benefit, a satisfaction of a need, or whatever, depending on the type of explanation offered. The persuasiveness of the explanation, however, depends on more than a description of an "impact"; it depends on the elaboration of a mechanism that connects the impact to some cause, intention, functional adaptation, or whatever: how the particular institution developed and why it took the form that it did. Here we connect the what with the how and why. Because my interest is in the development of theories that combine rational action with institutional structures, my attention here is on mechanisms that connect the benefits of social institutions with the intentions of social actors. The basic argument of this chapter is that although social institutions may have a number of discernible benefits, some do better than others in providing the how and why.

In the first section I briefly discuss the benefits provided by a variety of social institutions. These examples are offered to highlight the relationship between the collective and distributive benefits of these institutions. In doing so I begin to illustrate the practical problem of focusing primarily on collective benefits. In the next section I discuss the theoretical questions related to rational-action models and institutional development and change more systematically, analyzing a number of existing theories that focus primarily on the collective benefits of these institutions. Here I argue that explanations of social institutions grounded in rational-action theory must give primary emphasis to distributive effects. This emphasis directs our attention to why and how social actors seek to establish particular institutional forms. In the last section I consider the implications for a social explanation of two sets of problems that

confront social actors who seek to establish institutions: uncertainty and cost (both transaction costs and the costs of collective action).

THE BENEFITS OF SOCIAL INSTITUTIONS

The focus on the provision of collective benefits is grounded in the central importance of social institutions in our lives. Without social institutions, the myriad of interactions constituting social life would be more difficult, if not impossible. The fact that the existence of these institutions makes possible these interactions understandably leads us to look at their impact on the collective interests of society. To see this we need only examine the importance of a variety of institutions for social, political, and economic affairs.

Measures of time and space

We take for granted many of these rules and measures, but conventions of time and space provide the context in which we live our lives. Consider, for instance, measures of time. Time, as designated by such measures as the day, the week, and the year, serves as a referent for planning our affairs and coordinating them with the actions of others. As societies have become more complex and the benefits of collective behavior in the economic and political realms multiplied, the need for a temporal referent to structure this behavior has increased (Zerubavel, 1985). The week, with its division of time into periods of work, rest, and, for many, religious observance, offers a method of coordinating activities that produce benefits for each member of the community.

A similar account can be given for the conventions by which we define and structure space and other physical objects. Here we can refer specifically to systems of weights and measures, the criteria by which we categorize and compare land, resources, crops, goods, and the like. Without common criteria, we would be unable to enter into many of the forms of cooperation and exchange necessary to benefit fully from these products and resources. The history of the development of such systems of measure demonstrates that as exchange and trade became more prominent aspects of economic life, the pressures for a common criterion of measure increased as well (Kula, 1986; Sydenham, 1979).

Property rights

The rights to property in a society are defined by rules that designate their appropriate use, control, and right to transfer. These rules may take the form of either informal rules and conventions or formal laws enforced by the state. The designation of these rights facilitates a wide

range of social interactions, from economic exchange to the peaceful resolution of disputes involving property. Basic economic exchange requires some initial definition of rights so that the participants in the exchange will know what they can exchange and what they are getting in return. Without these initial definitions the stability of exchange would be threatened, and the potential gains from trade might be lost (Coase, 1960). To the extent that the members of a society are able to participate and benefit in these economic exchanges, established rules of property accrue to the benefit of the society as a whole. Similarly, rules are often established to anticipate disputes arising from problems with the division of property that frequently arise in a community, problems such as bankruptcy and intestate succession (Eisenberg, 1976). Here the rule has the effect of establishing a criterion for dispute resolution that prevents the potential disputants from diminishing the value of the property in the course of their distributional conflict.

Marriage and other rules governing the family

The family is the basic unit of association in most societies; and an extensive set of rules and procedures has developed to define both the relationship between the family and the community in which it lives and the relationship among the members of the family. These rules have important effects on the social relationships within a community: They define what constitutes a family unit; they define a social division of labor within a family; they establish rights between adult family members and between parents and children; and they establish the duties and responsibilities of family members vis-à-vis the outside community (Moore, 1989). This clarification of social relations can benefit the general community in many ways. To the extent that the members of a community are concerned with reproducing themselves through future generations, well-defined duties and responsibilities in regard to children can simplify the task of providing welfare and security. To the extent that the continuing social security and welfare of adults and, more importantly, the elderly is a product of cooperative behavior among members of the extended family, similar rules can stabilize and facilitate the satisfaction of those needs. These rules tell people for whom they are responsible and on whom they can rely in satisfying security and welfare needs (Comaroff and Roberts, 1981).

The organization of economic production and distribution

In most societies, economic gains result from cooperation in production and exchange. In less-developed economies, such gains may result from

the coordination of agricultural activities, cooperation in tool production or cattle development, or the long-term pooling of resources as a form of community insurance (Bates, 1989). In more-developed economies, these gains arise from the division of labor and specialization of productive activities (North, 1990). These collective activities are organized by institutionalizing procedures for production and distribution. Consider the modern firm: Production techniques and procedures are established by rules governing every aspect of the firm's activity. Without some stable procedures, many of the gains from cooperative production would be lost in the chaos of informal efforts to coordinate the division of labor. Concomitant with the rise of collective economic activity is the increasing complexity of distributive questions: How are the gains from collective action to be divided? In the case of the modern firm these distributive questions have been resolved within the institutional framework of bargaining between labor and management. In a manner similar to some of the rules of property division, this framework can structure distributional bargaining in such a way as to make it less likely that the gains from collective production will be lost in the conflict over their distribution.

Political institutions of the state

Just as economic actors can benefit from collective activity, social actors can benefit from the activities of a centralized government authority. The benefits of such activities as the production of public goods and the enforcement of property rights are well documented. Governments are organized according to a network of political institutions that facilitate collective decision making and coordinate the activities of government officials. Two examples from democratic societies are illustrative: Electoral laws offer an institutional method of translating the preferences of individual voters into governmental policy through the election of legislative representatives (Rae, 1967). The institutions of the legislature provide a framework within which representatives can conduct the business of lawmaking; the established rules and procedures allow representatives to develop the long-term relationships and coalitions from which policy is made (Weingast and Marshall, 1988). Without these fixed procedures, the process of political decision making would be more difficult and more costly.

Summary

This sketch of various social institutions gives us a sense of the difference that these institutions make in social life. Institutions make life easier; in

a world of social interdependence, they provide a means of living and working together. They allow social actors to produce, by acting with others, benefits that they would fail to achieve by acting alone. In some contexts, these benefits are called *gains from trade;* in others, *gains from cooperation;* in still others, *advantages of coordination.* The stability of these institutions and the knowledge of that stability shared by the members of a group or community enable the types of behavior necessary to achieve these benefits. It is not surprising that these collective benefits form the basis of an answer to the question of what difference social institutions make.

But this is an incomplete sketch. For although we need stable institutions to achieve the benefits of acting together, these institutions can take many forms. In most cases there are a number of ways to institutionalize the rights, duties, responsibilities, procedures, methods of action, appropriate strategies, and the like so that the additional benefits of collective action or social coordination can be realized. Consider the following examples. Some of our measures of time, such as the year or the day, have an underlying astronomical basis, but others, such as the week, are merely conventional. Even the measures of the year and the day have been subject to variation in criteria and interpretation (Rifkin, 1987: 76–8; Whitrow, 1988: 4). In order to coordinate behavior in a community we need a common criterion of time such as the week, but it need not be seven days in duration. Historically, weeks of varying lengths have structured the economic and social lives of different communities (Zerubavel, 1985). Similarly, although a community needs a common set of measures for land and other resources to facilitate commerce, many different sets of measures can, and have, served as that criterion (Kula, 1986: 98–122; Thompson, 1928: 596, 736).

Rules of property division, in the form of either informal convention or formal law, also take various forms. For example, the criteria for resolving such problems as bankruptcy or intestate succession have differed historically among nations and among communities within a single nation (Dalhuisen, 1968; Lloyd, 1877). The common characteristic of these rules is that they have established a stable criterion on which social actors can anticipate the future and act accordingly. But they have differed substantially in the exact method of distribution. Property rights have also entered into the network of institutions defining relationships within the family. They have been particularly important to defining the differing social and economic responsibilities between husbands and wives (Sen, 1990). Here, too, the collective benefits gained from a clear and precise delineation of duties and responsibilities have taken many forms. One way of characterizing these differences is in their treatment of women: To what extent are the rules gender neutral, and to what

extent are wives treated in the same manner as their husbands are (Carr and Walsh, 1977: 564; Salmon, 1986: chap. 7)?

As we move from these underlying conventions and norms to those institutions usually characterized by a more intentional form of development, we can find a similar diversity. The basic organization of economic production can have a number of different institutional forms (Elster and Moene, 1988), as can the rules and procedures established for resolving issues related to working conditions and distribution (Clegg, 1976). The institutionalization of the state's political activities differs across a wide range of electoral and administrative forms (Lijphart, 1984).

The main point here is that there is generally more than one way to structure social institutions in order to produce gains from cooperation, coordination, or exchange. And the major distinguishing feature of these different institutional forms is their distributional consequences. Although they all can produce gains from acting collectively, they distribute these additional benefits differently. The establishment of conventions of measurement can significantly affect the distribution of economic and political benefits in a community; and the method of defining property rights can affect the distribution of economic benefits. The network of conventions and formal rules defining relationships in the family can substantially alter the relationship between the sexes and the enjoyment of the various benefits of social life. The structuring of the various economic and political institutions that constitute the framework of social life can dramatically influence the fundamental distribution of economic and political success and failure in a community. And all of this also provides the structure and stability necessary for social actors to produce gains from cooperative behavior.

The practical implications for explanations of institutional development, maintenance, and change are straightforward. Such explanations must do more than demonstrate that social institutions exist because they benefit us. For example, it is not enough to say that particular property rights can be explained by the fact that they enhance the efficiency of economic exchange. Several different sets of property rights can do this. Our theories thus must explain why one institutional form developed, as opposed to another, when a number of different ones will produce the basic benefits; that is, why one set of property rights evolved and another did not.[1]

One response to this criticism of theories based on collective benefits takes the following form: We can explain the development of a partic-

1 Note that these examples are manifestations of the problem of multiple equilibria in rational-choice models. Any of several institutional forms constitutes an equilibrium outcome. The question is, Why one equilibrium over another? This formulation of the problem is developed in Chapters 3 and 5.

ular social institution by the fact that it does a better job than do competing institutional forms of providing these collective benefits. For example, certain property rights are more efficient; they do a better job of minimizing costs; they are Pareto superior to other alternatives; and so forth. This is the implicit logic of many of the explanations to be discussed in this book. For these explanations to be acceptable, however, they need to demonstrate why the collective benefits are the key element of the explanation. To do so they should elaborate a mechanism that either connects collective benefits to the actors' intentions or shows how collective benefits are produced despite the actors' intentions. Here we turn from the practical problems of explanation to more theoretical issues.

RATIONALITY AND INSTITUTIONAL BENEFITS

Rational-choice accounts of social institutions are in principle dedicated to explanations based on the intentions and motivations of social actors (Davidson, 1980; Elster, 1986). This implies a particular focus on institutional development and change. If institutional rules are intended to influence future action, these rules should embody the substantive effects that their producers desire. Here it is important to clarify the difference between intended and unintended consequences. If social institutions are the product of human interaction, the substantive content of institutional rules should embody the goals and motivations underlying those interactions. Just as the provisions of a contract reflect the intentions of the parties to that contract, institutional rules should reflect the intended effects desired by those who produce them. This does not mean that institutional effects will duplicate the exact preferences of any particular actor or group; in fact, this will seldom be the case. Rather, the final form of institutional rules is a product of the conflict of interests among the relevant actors. This final product is grounded, however, in the intentions and motivations of the conflicting actors.

If these institutions either fail to produce these effects or produce unintended consequences that counteract the desired effects, it will be necessary to look to other mechanisms by which these unintended effects are produced. We need to explain the intervening factor that produced the unintended effect; otherwise, explanations of institutional effects that rely on unintended consequences can lapse into unspecified functionalism.

In relying on intentional explanations to analyze institutional effects on social outcomes, we commit ourselves to concentrating initially on the substantive content of these rules and only later on their unintended effects. In Chapter 1 I suggested that relying on the concept of rational

action did not commit us to a narrow, "self-interest" view of individual preferences. Though this is true, I now propose that we restrict our assumption about preferences to one of individual self-interest (what, following Hardin, 1982, I will call *narrow rationality*). This restriction is justified on several grounds. First, by adopting a narrow perspective on the motivations underlying social institutions, we can use our conclusions as a baseline to compare explanations that relax this assumption. If we understand what the nature of social institutions would be in a world of narrowly rational social actors, we can then focus on the changes that might result if these actors adopted more other-regarding preferences. Second, the assumption of narrow rationality allows us to emphasize the conflict that characterizes many aspects of social life. The third, and probably the most important, justification is that this perspective serves as the basis for other analyses of the rationality of social institutions.

If we want to explain the development and maintenance of social institutions in terms of the relevant actors' preferences, we will need to specify what rational actors want the substantive content of such rules to be in the context of diverse distributional forms. For the dominant contemporary account of social institutions to be sustained, the strategic actors' main concern must be the collective benefits provided by these institutions. The question therefore is whether strategic actors would give priority to collective goals over distributional advantage in the development of social institutions. If they are motivated by the narrow self-interest assumed by standard analyses, the answer will be no.

To see this, consider the following analysis. The existing theoretical literature is based mainly on three social goals: social efficiency, Pareto optimality, and stability. These concepts are theoretical measures of the types of gain from coordinated action produced by social institutions. Contemporary arguments explain social institutions in terms of the provision of these goals: Social institutions constrain actors (either society as a whole or subgroups) as a way of achieving these collective benefits. We therefore need to determine the compatibility of these goals with the assumption of narrow rationality. I begin by analyzing the ways in which social efficiency has formed the cornerstone of contemporary explanations of the existence of social institutions. Then I turn to Pareto optimality and stability and discuss the relationship of these concepts to the rationality of institutional development and change.

Social efficiency

By *social efficiency* I am referring to what Coleman (1988: 71) defines as *allocative efficiency:* the maximum productive use of resources. In this

sense, efficient social institutions are those that maximize social welfare or utility. Technically, this measure raises several conceptual problems for comparative institutional analysis. First, this concept assumes that there is some way for us to make interpersonal comparisons of utility among social actors in order to aggregate individual utilities and maximize collective welfare. The problems with this assumption are well known (Hardin, 1988: 169–78). The simplest way of thinking about the problem is to remember that the utility functions employed in rational-choice explanations are inherently subjective. The criterion by which I measure my utility is based on my own evaluation of alternatives, and so it is unique to me. The assumption of interpersonal utility comparisons entails a transferable utility requiring a shared criterion of value. Given the idiosyncratic criteria of subjective utility functions, the requirement of transferability has not been fulfilled, and so interpersonal comparisons cannot be made.

Second, the measurement in terms of utility can be problematic when employed as a means of comparing the relative efficiency of different institutional arrangements. Eggertsson points out that changes brought about by reallocating property rights can produce new indifference curves and a new criterion to assess efficiency. He suggests that such a change "affects both the production capacity of the economy and the distribution of wealth, and creates, in a market economy, a new basis for the valuation of commodities. Therefore, from the viewpoint of positive economics, it is impossible to evaluate the impact of changes in property rights on social welfare" (1990: 100–1). Here the problem comes when determining changes in aggregate utility after changes in the nature of a particular social institution. To make such an assessment we must have a criterion of aggregate utility that remains consistent both before and after the institutional change. If the institutional change to be examined also affects changes in the underlying context in which social outcomes are to be evaluated (e.g., if our preferences for social outcomes vary with the level of resources at our disposal), our underlying preference rankings may change, thereby altering the criterion for aggregate utility. Thus, the pre-change and post-change criteria may differ, thwarting efforts both to compare utility changes and to attribute such changes to specific alterations in social institutions.

Both of these problems call into question a comparison of different institutional forms in terms of utility. Although these conceptual problems in themselves tend to undercut claims about the relative efficiency of different institutional forms, I want to set these problems aside, assume that relative comparisons are possible, and assess the relationship between this efficiency concept and narrow rationality. For this purpose we can

think about social efficiency as measuring how well institutional arrangements allow us to enjoy gains from coordinated behavior. All we need here is the rather simple assumption that social actors can roughly determine the relative gains of different institutional forms. Thus, socially efficient institutions would be those rules that produce the greatest collective gain.

In studies of institutional development, social efficiency has been used to explain the existence of such institutions as the basic network of conventions and norms in a society, property rights, law, and various forms of political and economic organization. Here we need to distinguish naive from sophisticated accounts. Whereas the naive explanations point merely to the provision of increased collective benefits, the more sophisticated accounts investigate how and under what circumstances institutions offer these benefits.

Consider, for an example of a naive account, the economic-analysis-of-law perspective, which employs social efficiency as a criterion to explain the substantive content of many areas of the law.[2] In describing the logic of this perspective, Posner asserted that "common law (i.e., judge-made) rules are often best explained as efforts, whether or not conscious, to bring about either Pareto or Kaldor–Hicks efficient outcomes"[3] (1987: 5). In this approach the maximization of social efficiency takes both an explanatory and a normative role. Legal rules and principles are both explained by and justified according to their ability to establish incentives to maximize welfare.

Consider, for example, rules that govern liability for unintentional torts (Landes and Posner, 1987). There are three basic forms of the liability rule: strict liability, negligence, and no-fault. The first places absolute responsibility on the tortfeasor, regardless of whether the tort could have been avoided; the second abrogates liability when the tort could not have been avoided with reasonable due care; and the third does away with the issue by placing responsibility for compensation on the victim's own insurance provider. The economic-analysis-of-law approach explains the existence of a particular liability rule in terms of the rule's effects on the incentives to take precautions against tortious behavior. If a strict liability criterion would do the best job of creating incentives for efficient precautions in a products liability case, that criterion would be

2 The seminal work in this area is by Posner (1986). The burgeoning literature can be found in the various volumes of the *Journal of Law and Economics* and the *Journal of Legal Studies*. For a discussion of the strengths and weaknesses of this approach, see, for example, Coleman, 1988, and Coleman and Paul, 1984.

3 It is not clear what Posner means by the "unconscious" effort to bring about efficiency. Given his invocation in other contexts of a mechanism of natural selection, he may have in mind some evolutionary process unrelated to the intentions of judges or other actors.

predicted by the approach. Here the precautionary behavior induced by the liability rule increases the collective benefits gained by society from the production and exchange of goods.

The law-and-economics approach distinguishes between judge-made law and law produced through the political process. Although it leaves open the possibility that the latter type of law will fail to maximize social efficiency, this approach generally predicts a socially efficient common law. This distinguishes law-and-economics explanations from those grounded in Coase's theory (1960) of transaction costs. Transaction costs "consist of the costs of arranging a contract and monitoring and enforcing it ex post, as opposed to production costs, which are the costs of executing a contract" (Matthews, 1986: 906). According to this approach, the most socially efficient social institution is the one that minimizes these costs. As I shall point out later, some of these transaction-costs theories allow for the possibility that the most socially efficient social institutions will not be produced. But even these rest their explanations for the existence of social institutions on the fact that such institutions lower the collective costs of transactions. Two examples demonstrate how Coase's theory is used to explain the existence of economic institutions.

First, Williamson (1975, 1985) argues that efficiency considerations can explain various ways of organizing economic activities at the level of production. The logic of his analysis stresses the importance of minimizing transaction costs. Different economic transactions have different types of costs. Economic actors can organize their transactions in numerous ways: by means of firms, markets, or some combination of both. The choice of organizational form is dictated by the corresponding costs: Actors choose the form that minimizes costs. For example, firms with hierarchical forms of decision making and related procedures for monitoring work performance are preferred to more cooperative procedures, because the former do a better job of minimizing the costs of production.

Note that the idea that institutions are created according to the principle of cost minimization is grounded in the notion of individual efficiency. Although Williamson (1986) argues that the transaction-costs approach allows us to break out of the neoclassical conception of the firm as a unitary actor, he falls back on the idea that institutional decisions are made by individual utility maximizers (in this case, the owners of capital). But this leaves the principal's agents (the employees) with a rather unimportant role in the analysis. Williamson finds unacceptable the idea that forms of workplace organization are the object of conflict between the owners of capital and the workers. Although others have contended that hierarchical forms of organization are created to maintain asymmetric

power relationships rather than to minimize costs (Marglin, 1974; Stone, 1974), he rejects such arguments on the grounds that such organizational forms would not be chosen by the principals if they were not efficient.[4] Yet what is individually efficient for the principals may not be socially efficient for the firm. If we reconceive of the firm as a group (principals and agents) seeking to maximize their collective welfare, we may have to reexamine Williamson's efficiency justification for certain forms of workplace organization.

Before going further into the weakness of Williamson's analysis, however, we should take account of the positive contributions of the transaction-costs approach. To see this, consider the related approach offered by North (1981, 1990). North employs a similar cost-minimization criterion in his explanation of the historical development of property rights and other political and economic institutions. Here institutions are created by principals (either political rulers or the owners of economic resources) to govern relationships with other principals and with their agents (citizens, bureaucrats, employees, etc.). These principals are motivated to create institutional forms that will maximize their individual utility. In order to do so they choose institutional rules that minimize the costs of doing so:

> As a first approximation we can say that property rights will be developed over resources and assets as a simple cost–benefit calculus of the costs of devising and enforcing such rights, as compared to the alternatives under the status quo. Changes in relative prices or relative scarcities of any kind lead to the creation of property rights when it becomes worthwhile to incur the costs of devising such rights. (North, 1990: 70)

A criticism of North's early theory (1981) is that it erroneously predicted the existence of socially efficient property rights and economic institutions.[5] His later account (1990) clarifies his theory and suggests three main causes of the inefficiency of social institutions. The first two relate to problems faced by the actors directly involved in the transaction. First, economic actors may not have the information and knowledge necessary to produce such institutions. They may want to create them, but either they lack the information necessary to do so, such as knowledge of the costs of monitoring long-term performance, or they have inadequate subjective models of social causation such that they fail to understand the effects of their efforts at institutionalization on the actions of others. Either of these problems can lead to the creation of socially inefficient institutions. Second, the costs of producing socially efficient institutions

4 See Goldberg, 1981, for a recent critique of these "radical" accounts of economic organization.

5 See Bowman, 1989, for an analysis of the importance of political factors for North's theory of institutional change.

may be prohibitive. That is, they may have the capacity to create rights that will do the best job of maximizing their collective welfare, but the costs of establishing and maintaining them offset the benefits of doing so. Here we should note a fundamental contribution of the transaction-costs approach to institutional change: Transaction costs serve here not to explain the existence of social institutions but, rather, to explain the constraints on efficient institutional development (I shall return to this point later).

The third cause of inefficiency involves, for North, the introduction of additional actors: the role of the state's political agents in enforcing rights. Enforcement is inefficient when "enforcement is undertaken by agents, whose own utility functions influence outcomes" (1990: 73). Because rulers may have interests that conflict with those of their subjects and because they choose rules that maximize their own interests, they may produce property rights schemes that do not maximize the collective welfare. Thus, the creation of socially efficient rights is thwarted by the contrary interests of political actors.

Here we arrive at the crux of the problem for explanations based on minimizing transaction costs or, for that matter, on maximizing social efficiency more generally. The possibility of a conflict between individual and collective interests is, contrary to North and the other transaction-costs theorists, much more widespread than are instances of state involvement. The reformulation of Williamson's conception of the firm as a group (managers and workers) seeking to maximize collective welfare offers only one example. The theoretical problem is what becomes of social efficiency when actors have conflicting interests.

The conflict between individual self-interest and social efficiency was clarified by Coleman (1984), among others. The logic of his argument can be applied to the choice of institutional rules, whether it be forms of organization in the workplace or property rights for society as a whole. Consider the outcomes represented in Figure 2.1. Say that outcome *A* is on the Pareto frontier, which represents those points that maximize the collective welfare of *X* and *Y*. How would each actor compare this outcome with outcomes *B* and *C*? *X* would prefer *C* to *A*, and *Y* would prefer *B* to *A* on the grounds that those outcomes would produce greater individual payoffs. Motivated by individual self-interest, the actors, faced with a choice of moving from either of these individually preferred outcomes to the more socially efficient one, would reject the move and opt for the less socially efficient alternative. Applying the logic to Williamson's analysis of the choice of economic organization in the workplace, owners of capital, acting rationally, would opt for less efficient forms of organization if these rules resulted in an increased relative share of profits. More generally, this demonstrates that self-interested

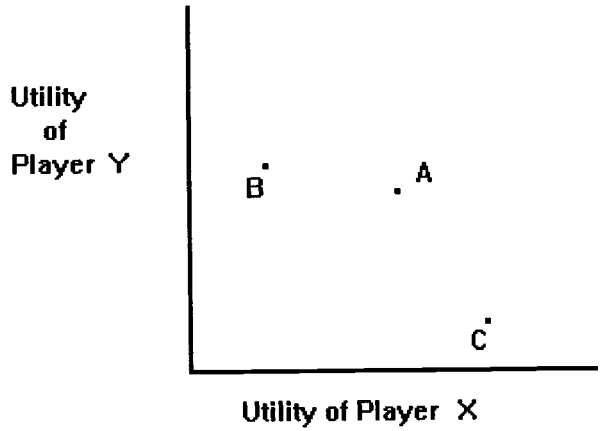

Figure 2.1. Social efficiency.

actors will prefer socially inefficient institutional rules if those rules give them greater individual utility.

For this reason I conclude that social efficiency cannot provide the substantive content of institutional rules. Rational self-interested actors will not be the initiators of such rules if they diminish their own utility. Therefore, rational-choice explanations of social institutions based on gains in social efficiency fail as long as they are grounded in the intentions of social actors.

Pareto optimality

The concepts of Pareto optimality and efficiency are often used to refer to the same features of social outcomes. Here I want to distinguish between the two in order to emphasize a different way of thinking about institutions. *Pareto-optimal* institutions have the following feature: Any change in the allocations produced by the institution benefits one actor only, at the expense of another. Institutions that are socially efficient are Pareto optimal, but the reverse need not hold. Institutions can be Pareto optimal without maximizing social welfare, as is the case when the only path to greater social welfare requires reducing the benefits to some members of the group (e.g., the move from *C* to *A* in Figure 2.1).

To clarify the importance of the criterion of Pareto optimality for the study of institutions, additional Paretian criteria must be introduced. An outcome will be Pareto superior to another if the welfare of at least one person can be improved by moving from the latter outcome to the former without adversely affecting the welfare of anyone else. An outcome will

be Pareto inferior if there is another distribution Pareto superior to it. The logic of the Paretian criteria is that rational actors make Pareto-superior moves until they achieve a Pareto-optimal outcome.

This logic of Pareto improvement is at the heart of many studies of institutional development. Schotter (1981) employs it in his discussion of the evolution of economic institutions in the marketplace, and the growing literature on norms and conventions (Hechter, Opp, and Wippler, 1990; Lewis, 1969; Sugden, 1986) rests on similar arguments. It provides the motivation for all arguments emphasizing the importance of institutions for the resolution of recurring problems faced by social actors. The social outcomes produced by such interactions without institutions are suboptimal; that is, they are Pareto inferior to other alternatives. Therefore, the motivation behind the production of social institutions is to achieve the Pareto-optimal alternatives.

In his discussion of the creation of economic institutions, Schotter succinctly puts together the logic of the argument: How do some institutions develop to help us achieve Pareto-optimal outcomes? I will analyze Schotter's discussion of institutional creation in a later chapter, but an important feature of that discussion is relevant to the idea of Pareto optimality as the motivation behind such institutions. Institutions will be created only if they produce outcomes Pareto superior to those that would be achieved in a world without institutions. Otherwise, they serve no beneficial purpose. Given problems of limited information and communication, Schotter acknowledges that Pareto-optimal institutions may not develop.[6] Yet for Schotter, this is a problem of the capacity to achieve one's goals (due to an inability to assimilate information) and not a change in the underlying motivation for one's actions. Pareto superiority becomes the criterion by which institutional creation and change are assessed.

At first glance, the concept of Pareto superiority seems to be uncontroversial. Why would self-interested actors object to Pareto-superior improvements produced by introducing social institutions? Although no one would be adversely affected in regard to losing present benefits, objections might be raised when the future implications of the relative changes in benefits are taken into consideration. Two cases need to be identified. If I am the person most benefited by the new institution, then I will not object to the Pareto-superior move. But what if others are to benefit and I am to gain (or lose) nothing? Then I might object. One ground for an objection rests on the effects that a relative change in benefits might have on my and others' future interactions in other contexts.

6 Sugden (1986) also acknowledges the possibility that evolving social conventions will not be Pareto optimal.

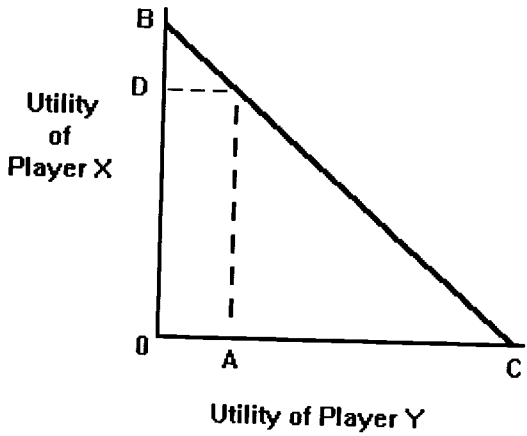

Figure 2.2. Pareto optimality.

For example, an increase in your present economic benefits might provide greater leverage in future political conflicts between us, producing inferior payoffs for me in the future. But a rejoinder could emphasize that such future changes that adversely affect me might be incorporated into the present welfare calculus.

Hardin (1984) proposed a second ground for an objection that is more devastating to the Pareto-superiority criterion. He points out that any present change affects those outcomes that will be judged Pareto superior in the future. Consider the relationship between players X and Y in Figure 2.2. If they start out at the origin, any move toward the Pareto frontier, BC, will be a Pareto-superior move. What then would X's reaction be to a proposed move to A? His benefits would not be affected; only Y's benefits would be improved. Yet X could rationally object to the move because of the changes it makes in what constitutes future Pareto-superior moves. Outcomes to the left of A are now ruled out; the maximum possible payoff available to X shrinks from B to D. If X has some future hope of achieving outcomes in the newly prohibited range and such future moves will be limited to Pareto improvements, he will object to the Pareto-superior move. This shows that "if I am narrowly rational, I can be indifferent to what you receive only if it does not potentially interact with what I can receive" (Hardin, 1984: 458).

This objection undercuts the claim that Pareto optimality is the underlying motivation for institutional creation. Social life is replete with instances in which my rewards interact with the rewards of others. Rational, self-interested actors who give substantive content to institutional rules do not opt for Pareto-superior alternatives if they can have adverse

future consequences. It is true, as Schotter admits, that social institutions may not achieve Pareto-optimal outcomes, but it is mainly for reasons quite different from those on which he relies for this conclusion. Social institutions may fail to achieve Pareto-optimal outcomes because it is not in the interests of those who establish those institutions to do so. Pareto-optimal institutions are contingent on the particular path by which self-interested actors achieve institutional change.

Stability

Stability is a quality of social outcomes different from that of social efficiency and Pareto optimality.[7] Whereas the latter two concepts refer to the substantive nature of social outcomes, stability is a formal characteristic. Social institutions may be stable even if they are neither socially efficient nor Pareto optimal. One aspect of institutional stability, a static feature, is contingent on the achievement of equilibrium outcomes. If no one wants to deviate from the institutional rules – given that everyone else is complying with them – the institution will be in equilibrium, and it will be stable in the weak sense that no individual has an incentive to violate the rule. A stronger sense of stability means that there is no group of individuals with an incentive to form a coalition and either violate or change the rule.

A second aspect of institutional stability pertains to dynamic elements. An institution is dynamically stable if the following condition holds: If a few actors inadvertently deviate from the institutional rule, the other actors will prefer to remain in compliance, and the deviating actors will have an incentive to return to the prevailing institutional form. This is an issue mainly in cases of multiple institutional equilibria. Such dynamically stable institutions are more likely to be maintained over time because they are less subject to change.

The stability produced by institutional arrangements is a major focus of the public-choice literature. Some of the earliest results in this field centered on the instability of democratic outcomes: Except under severely restrictive conditions regarding the nature of individual preferences, the aggregation of such preferences is subject to cycles among the various collective outcomes (Ordeshook, 1986). Shepsle (1979) demonstrated that institutional rules could reduce this instability, and he introduced the notion of structurally induced equilibria to explain the existence of certain types of equilibria that would not emerge without the

7 Stability is a complex notion, and I can address in this chapter only a few of the ideas directly related to institutions. See Schwartz, 1986, for a presentation of the complexities inherent in the meaning of stability.

constraints that institutions place on feasible collective outcomes. Here institutional rules provide the much-needed stability for democratic institutions.

But one can easily see that the benefits from stability depend on the substantive nature of the outcomes. For example, if I live in a democratic society as a member of a segment of the population that never prevails on policy questions – what Barry (1982) labels a "permanent minority" – then the benefits of stable democratic institutions are less valued by me and others similarly situated. More generally, if I am consistently slighted in the outcomes produced by a stable institutional arrangement, stability will seem like a mixed blessing. On the one hand, institutional stability increases the reliability of the information used in formulating expectations about future behavior. On the other hand, the stability of inferior payoffs leads me to want to change the prevailing institutional arrangements. Given the potentially negative implications of stable institutional arrangements, it is easy to conclude that stability alone does not motivate the substantive content of institutional rules.

Summary

This analysis of the concepts of social efficiency, Pareto optimality, and stability leads to the following conclusion: The primary motivation for social institutions cannot be the achievement of collective goals. Such goals are inconsistent with the narrow rationality underlying these institutions. Rather, institutional rules are created by and communicated through the claims and actions of rational actors. To the extent that such rules can have substantive effects on social outcomes, the substantive content of those rules should reflect the self-interest that motivates these claims and actions. Rather than focusing on collective goals, self-interested actors want institutions that produce those social outcomes that are best for them as individual strategic actors.

This is not to say that social institutions do not produce benefits for all of the members of a group or community. Self-interested actors will not comply with social institutions if compliance does not give them greater benefits than does noncompliance. As the examples in the previous section suggest (and as I will show in the next chapter), compared with the lack of relevant institutions, stable social institutions do in fact provide such benefits. Thus, this insistence on the theoretical primacy of distribution does not deny the importance of gains from coordination or trade. The main point here is that such gains cannot serve as the basis for a social explanation; rather, these benefits are merely a by-product of the pursuit of individual gain. If we want to ground explanations in terms of

the intentions and actions of rational actors, we must look to the distributional consequences of those institutions.

Theories of social institutions that emphasize these collective benefits cannot provide microfoundations for their explanations in terms of individual rational action. If they insist on grounding their explanations in collective benefits, they must describe the mechanism that transforms the effects of social institutions into collectively beneficial forms. That is, rational-choice theories that ignore the pursuit of distributional gain and concentrate on collective benefits must describe the mechanism that restricts self-interested behavior exclusively to mutually beneficial changes. Consider what this mechanism might be. It cannot be merely the existence of external enforcement, as is implied by many standard accounts. Such enforcement is created by strategic actors to ensure compliance with institutional rules. Because there is nothing about strategic rationality that guarantees social efficiency in the substantive content of social institutions, there is nothing in the existence of the enforcement mechanism that guarantees it. An external-enforcement mechanism is a means of securing binding claims, not a mechanism guaranteeing social efficiency.

Rather, the mechanism must be something outside the direct control of individual strategic actors. One such possibility is found in North's use (1981) of Alchian's argument (1950) concerning the efficiency of the market: The pressure of market competition serves as a selection mechanism for socially efficient economic institutions, forcing out firms that fail to perform in a utility-maximizing way.[8] But this argument suggests what a difficult problem one faces when describing such a mechanism. Here the mechanism is the competition produced by the existence of a large number of economic actors in close proximity to one another who are pursuing the same goal. To be applicable to the development of institutions more generally, we would have to find the conditions for a "market" for social institutions. The problem is that even if Alchian is correct about the workings of a perfectly competitive market, the requirements of (1) a large number of actors (2) employing a wide range of institutional forms (3) in close proximity to one another (4) in pursuit of the same goal are a difficult standard to meet in the development of most social institutions. I will consider the viability of such explanations of institutional development and change in Chapter 4.

8 Note again that the market is structured by institutional rules that are the product of human creation. Given this fact, we know that these rules also have distributional effects on social outcomes. This, in a sense, merely sets back by one step the question of institutional development and change. See Ensminger, 1992, for an illuminating account of the development of market institutions.

Without a similar mechanism, relying on such collective benefits to explain social institutions is reduced to functionalist musings: Social institutions exist to satisfy the functional needs of a group or society, even though they are not created with those needs in mind. Such arguments are reminiscent of the description offered by Posner of the economic-analysis-of-law approach: "I emphasize once again that, in suggesting that primitive people are economically rational, I am not making any statement about their conscious states. Rational behavior to an economist is a matter of consequences rather than intentions, and in that respect resembles the concept of functionality in traditional anthropology" (1980: 53). But an "explanation" based on positive consequences without a mechanism detailing their development is more an expression of faith than an explanation.[9]

A DISTRIBUTIVE CONCEPTION OF SOCIAL INSTITUTIONS

Social institutions affect the distribution of benefits from the numerous interactions that constitute social life. Although it is true that we need such institutions to reap the gains from these interactions, the forms of these benefiting institutions vary across time within a particular society and across communities and societies at any particular time. As I have suggested and will continue to emphasize throughout this book, what separates these distinct forms is their distributional consequences.

The importance of distributional consequences implies the following conception of social institutions: Institutions are not created to constrain groups or societies in an effort to avoid suboptimal outcomes but, rather, are the by-product of substantive conflicts over the distributions inherent in social outcomes. According to this conception, the main goal of those who develop institutional rules is to gain strategic advantage vis-à-vis other actors, and therefore, the substantive content of those rules should generally reflect distributional concerns. The resulting institutions may or may not be socially efficient: It depends on whether or not the institutional form that distributionally favors the actors capable of asserting their strategic advantage is socially efficient. Note that the inefficiency need not arise from any incapacity of the actors (due to either lack of information or faulty understanding) but, rather, from their self-interest, their pursuit of a less efficient alternative that gives them a greater individual gain.

The role of distribution in explanations of social institutions has recently received more attention. Libecap (1989) introduced distributional

9 For a discussion of the strengths of functional explanations, see Cohen, 1978, 1982a, and 1982b, and Hardin, 1980. The problems and weaknesses of such explanations are discussed in Elster, 1978, 1980, and 1982.

conflict into his explanation of efforts by economic actors to contract for rights over property. Bates (1989, 1990) emphasized the inefficiencies produced by distributional concerns in property rights and kinship systems. And Tsebelis (1990: 92–118) proposed a distinction between efficient and redistributive institutions in his analysis of the existence of differing forms of political and economic association. Although each of these efforts contributes to our understanding of institutional change (I will discuss them in more detail in subsequent sections), their analyses have been limited mainly to discussions of intentional design and the implications for inefficiency. Here I want to insist on the primacy of distributional consequences in all aspects of explaining social institutions, especially in explaining the spontaneous emergence of the informal conventions and norms on which societies are based.

North presents a challenge for those who seek to emphasize distributional questions: "To the extent that exploitation models are to be convincing they must demonstrate that the institutional framework does indeed produce the systematic uneven consequences implied by the theory" (1990: 178). Such distributive explanations must address two general questions: (1) Who does the institution systematically favor? and (2) How might those so favored have gained these benefits? This should direct our attention to those factors influencing the capacity of strategic actors to determine the substantive content of institutional rules, and this introduces questions of the asymmetries of power in a community.

Introducing power into analyses of social life raises complicated conceptual issues. Rational-choice accounts have generally avoided the concept and opted instead for analyses of problems arising among equals.[10] There is good reason to be wary of employing power asymmetries in our explanations, because they too often result in ex post rationalizations of social outcomes. That is, we attribute a power advantage after the fact to those who are successful in achieving their goals. For power to have an explanatory role in our analyses of social institutions, it must be something more than an ex post description of events; it must be something that we can identify ex ante.

The possible definitions of power are numerous.[11] Here I propose the following working definition: To exercise power over someone or some group is to affect by some means the alternatives available to that person or group. To use more formal language, power relates to the ability to affect one's feasible set. This can be accomplished in a number of ways. First, *A* can constrain *B*'s feasible alternatives in such a way that it

10 Note that this is one of the main criticisms of rational-choice explanations of social institutions. See Oberschall and Leifer, 1986, and Zald, 1987.

11 See Lukes, 1974, and Morriss, 1987, for analyses of the competing definitions.

precludes choices that are in *B*'s interests. Second, *A* can expand *B*'s feasible set by adding alternatives that are in accord with *B*'s subjective interests but are contrary to *B*'s real interests. Third, *A* can fail to act in such a way that it prevents certain alternatives from becoming available in *B*'s feasible set. This failure can be a deliberate withholding of certain preferred alternatives, or it can merely be a failure to remove a constraint that prevents the possibility of making such choices. Fourth, *A* can alter *B*'s valuation of the available alternatives by threatening a retaliatory action that would make an available alternative less attractive. Fifth, *A* can change *B*'s understanding of the alternatives, by manipulating *B*'s preferences. And there are surely other ways in which one can adversely affect someone's freedom of action.

The key here for a strategic analysis of the emergence of social institutions is how some actors can affect the alternatives available to others in such a way as to get them to act in a way that they would not otherwise choose to do: how *A* can get *B* to adopt an institutional rule that distributionally favors *A* (when other alternatives would be better for *B*). If we are to attribute to *A* power over *B*, our analysis must concentrate on the conditions under which *A* adversely affects *B*'s freedom of action. This calls our attention to the differences among a community's individuals and groups that allow actors to achieve strategic advantage. Such differences are numerous, but I shall limit my analysis to asymmetries in the possession of resources used in the pursuit of substantive outcomes. Examples range from the resources employed in the use of violence, which North (1981) has documented, to levels of membership in various unions and political parties to the other alternatives available to actors in social interactions. Although some may raise questions about the ambiguity of this formulation, few would disagree, I think, with the premise that these asymmetries in resources capture an important characteristic of asymmetries of power. It is by analyzing these resource asymmetries that we obtain an important measure of asymmetries in power.[12]

Explanations of social institutions in terms of their distributional consequences are complicated by factors that can undercut the strategic advantage enjoyed by social actors. From an analytical perspective, the problem is that we may not find the level of distributional consequences that is predicted from the resource asymmetries in a community. The reason is that social actors may be confronted by barriers to the successful establishment of social institutions that can produce distributional advantages. Two such factors will be considered here – the costs of collec-

12 I have postponed further elaboration of the explanatory role of power asymmetries in a theory of institutional change until Chapters 4 and 5.

tive action and uncertainty.[13] I introduce these factors now to anticipate possible objections to my insisting on the primacy of distribution and power asymmetries in the emergence of social institutions. It is easiest to understand these objections by considering them from the perspective of an individual who is designing a social institution: What are the implications for designing and creating the institution most favorable to me?

Costs

The costs of institutional development can significantly affect the final form of institutional arrangements. By definition, rational actors will not create institutions if the costs of doing so exceed the benefits that they subsequently provide. This has been one of the central lessons of the transaction-costs literature. Such costs enter into the analysis in two ways. First, in regard to the effects on the establishment of rules for small groups, the emphasis has been mainly on the costs to individuals of drafting and enforcing contracts governing property rights and other forms of economic organization. These costs can explain why rights that would appear to produce greater gains from trade are rejected on grounds of the costliness of their enforcement. Second, in regard to the effects on the collective institutional action of the community as a whole, Eggertsson explains the inefficiency of state institutions as follows: "High (transaction) costs of collective action are the principal reason why the members of a community cannot agree on new rules that would increase the community's aggregate output" (1990: 214). The costs of overcoming the well-known problems associated with collective action prevent the establishment of more socially efficient laws.[14]

Although the transaction-costs literature centers on the collective benefits of these institutions, social actors who seek to establish distributionally favorable institutions face similar cost problems. The distributional consequences of such institutions highlight two additional aspects of the cost problem. As for the costs of enforcing institutional compliance, distributional bias divides social actors into those groups who reap the larger share of the benefits and those who prefer a more favorable institutional arrangement. This possibility of tension for institutional change

13 As noted in an earlier discussion of the classic texts, Smith emphasized a third factor that can inhibit the use of a strategic power advantage: market competition. The existence of competition can, in fact, diminish the value of asymmetries of resources in the development of social institutions. I have postponed discussion of the effects of competition on strategic power until Chapter 4 so that I can take it up in the context of a more comprehensive consideration of the general role of competition and the market in theories of institutional change.

14 The problems of collective action and free riding were made famous by Olson (1965). Accounts elaborating the issues associated with these problems include those by Hardin (1982) and Taylor (1987).

can increase the costs of enforcement and will, therefore, enter into the cost-benefit calculation of those who benefit disproportionately from the institution. If the costs are substantial, these actors may opt for an alternative rule that is less distributionally biased as a means of lessening the tension for change. As for the costs of collective action, distributional bias increases the costs for social actors who seek to bring about collective change. Not only do they have to incur the normal costs of any collective endeavor, but they also have to incur the additional costs introduced by those who benefit from the existing rules and who will fight efforts at redistributive change.

Yet the existence of these additional costs should not preclude the pursuit of distributional advantage in the establishment of social institutions; they are merely an additional factor to be considered by strategic actors in distributional conflict. Here we need to distinguish institutions that emerge spontaneously from those that are the product of intentional design. These costs of enforcement are an important aspect of explanations of intentional institutional design and change and, therefore, of institutional stability. For institutions that emerge over time, the establishment of institutional rules is an unintended consequence of repeated social interaction. Thus, any costs included in the actors' strategic considerations are limited to those included in the choice of action in those interactions.

Uncertainty

Uncertainty about the relationship between our actions and the outcomes they produce makes rational action difficult. If we do not know the exact relationship between the choice of an institutional rule and the subsequent effects of that rule, the quest for the institutionalization of strategic and distributional advantage will be hampered. The standard argument concerning the effects of uncertainty on institutional development was restated by Tsebelis (1990): Uncertainty causes social actors to design institutions based on the criterion of social efficiency and not on redistributive advantage, focusing on collective welfare and not on individual gain. The logic is that uncertain social actors hedge their bets and adopt a risk-averse institutional strategy: to create social institutions for the average social actor (thus seeking to maximize social efficiency).

In considering the implications of this standard account, we should note that social actors can be uncertain about many things in their efforts to design social institutions. For the moment we can set aside the principal uncertainty facing social actors – uncertainty about the actions of others with whom they interact. (This strategic uncertainty requires an extended discussion that I will postpone until the next chapter.)

The primary importance of distributional conflict

Here I shall concentrate on those types of uncertainty that an individual actor would confront if she were free to design any type of institutional rule she wanted. This will allow me to focus on the effects of uncertainty on an individual's unconstrained preferences over feasible institutional alternatives. Social actors can be uncertain about (1) the present institutional alternatives available to them, (2) the present consequences of their present institutional choices, (3) the future consequences of their present institutional choices, (4) the future institutional alternatives that will be available to them, and (5) their future preferences regarding future alternatives and outcomes. Each of these forms of uncertainty can influence efforts to institutionalize distributional advantage. But the implications for explanations of social institutions differ depending on whether the institutionalization is the product of intentional design or of an unintentional evolutionary process.

Uncertainty about present factors, either alternatives or consequences, influences the actions that lead to both intentional and unintentional institutional development. This is the basic problem of a lack of information about the consequences of institution formation emphasized by North (among others) in his work on economic institutions. Social actors may not be able to establish a distributional advantage if they do not understand how an institutional rule works. Here we might expect two types of behavior: either experimentation with different institutional forms in an effort to obtain more information about institutional effects or the establishment of rules that can easily be changed.

Uncertainty about either future consequences or future preferences regarding outcomes can significantly affect efforts at intentional institutional design but has little effect on unintentional evolutionary processes. Both forms of uncertainty complicate intentional design because they relate to the future effects of presently created institutions. If social actors are uncertain about future effects, how can they design institutions that ensure long-term distributional advantage? First, this uncertainty may include doubts about the continuing effects of these institutions. Say we establish a rule at t_1 that we know will distributionally favor the owners of capital. But we may not know whether future circumstances will be such that the rule will continue to favor owners of capital at t_{1+n}. This is another form of the problem of the lack of information about how to structure social institutions to meet our needs.

But there is a second, more vexing form of future uncertainty for social actors: uncertainty about their own future status in a community. This is a variation of Rawls's veil-of-ignorance decision problem (1971): What kinds of institutions do we want when we are uncertain about our own position in the community? Thinking back to our institutions established to favor capitalists at t_1, the problem is whether I will still be an owner

of capital at t_{1+n}. This is the type of uncertainty envisioned by Tsebelis's argument in favor of efficient institutions. Here the question of the effects of uncertainty about the future is tied up with questions of how much the future means to social actors (i.e., how much they discount the future).

The argument that uncertainty induces a greater concern about social efficiency seems to rest on the idea that uncertain actors forgo present distributional advantage in order to protect against the possibility of future harm (Brennan and Buchanan, 1985: 28-31). But this does not take sufficient account of the possibility that if we are uncertain about the future, we may discount its importance when calculating the utility of our present actions (Taylor, 1987). That is, the more that we discount the future, the more that we will base our present institutional choices on short-term distributional gain.

Even if the uncertainty does not produce serious discounting of the future, its constraint on the pursuit of distributional advantage may be overstated. If the actors are confronted by real uncertainty (meaning that they cannot predict the future with any reliable probability), we may expect the following behavior: whereas they deemphasize their efforts to achieve long-term distributional advantage (possibly relying on institutions that are easily changed), they resist efforts to establish institutions that disfavor them. The vast literature growing out of Rawls's theory of justice testifies to the interesting intellectual puzzle created by this problem. But this formulation of such extreme uncertainty abstracts too much from the choices faced by real-life social actors. There are many things about the future that people do know: Women will still be women; African Americans will still be African Americans; young people will grow old (or die); and so forth. Although people do not know with similar confidence that they will maintain their present economic and political status, they do know from experience that dramatic shifts in political and economic fortune are unlikely. Thus, social actors who seek long-term distributional advantage have substantial evidence about their future status in a community on which to base their actions. To the extent that social actors are confronted by this partial uncertainty, the literature on judgment under conditions of uncertainty states that we should expect them to base their expectations about their future status on their present evidence and so seek institutions that favor those people whom they expect to be in the future.[15]

Finally, uncertainty about future institutional alternatives deserves a brief mention. Such uncertainty has no real effect on intentional design.

15 See the studies by Kahneman, Slovic, and Tversky (1982) and by Arkes and Hammond (1986) for evidence of the ways in which social actors employ the experiential evidence available to them when choosing among uncertain alternatives.

Nelson and Winter distinguish this kind of uncertainty from some of the other types we considered:

> There is . . . a fundamental difference between a situation in which a decision maker is uncertain about the state of X and a situation in which the decision maker has not given any thought to whether X matters or not, between a situation in which a prethought event judged of low probability occurs and a situation in which something occurs that never has been thought about, between judging an action unlikely to succeed and never thinking about an action. The latter situations in each pair are not adequately modeled in terms of low probabilities. Rather, they are not in the decision maker's considerations at all. (1982: 67)

For those actors who seek to design an institution at t_1, unforeseen technologies and mechanisms that might be available for the creation of new institutions at t_{1+n} do not enter into their calculations. Nonetheless, a lack of knowledge of such future alternatives may appear to undercut my criticism of the Pareto-superiority criterion. Remember that my criticism there was that in strategic situations social actors may rationally reject Pareto-superior forms of institutional change if those changes preclude future changes that are distributionally superior for them. However, if they lack any knowledge of these superior changes – so the challenge to my criticism might go – why will they not accept any Pareto-superior move? Here, I think, my criticism is sustained by the mere fact that institutional change tends to preclude future alternatives; that is, institutional change is path dependent (North, 1990: 130). As long as social actors know that present changes in the way we do things can count out future alternatives, they can rationally resist Pareto-superior moves in strategic situations.

In summary, although costs and uncertainty can complicate the pursuit of strategic advantage in the development of social institutions and should, therefore, be incorporated into the analysis, they should not undercut the importance of distributional consequences in our explanations of these institutions. To understand how social conflict and power asymmetries can form the basis of a theory of institutional stability and change, it is necessary to investigate how social institutions affect the rationality of social action. This requires an examination of the effects of institutional rules on strategic decision making.