

Sources of the New Institutionalism

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The new institutionalism in sociology is part of an emerging paradigm in the social sciences. Interest in the new institutional paradigm is being driven by advances in interdisciplinary research directed at understanding and explaining institutions. In economics, this has involved rejection of the neoclassical assumption of efficiency in transactions that purportedly are costless and based on complete information. In political science, intellectual trade with economics has given rise to the field of positive political economy, which is extending the paradigm to the analysis of political institutions and the politics of markets. There this paradigm has established itself as the most influential, but political science has had a long history of being the “beneficiary as well as the victim of many intellectual currents from other disciplines” (Ordeshook 1990, 9). Although sociology has been less responsive than political science, this is quickly changing. Just as central themes in classical sociology have influenced the new institutionalists in economics (North 1981), this branch of economics has led sociologists to examine economic phenomena anew. The new institutional economics has contributed to stimulating research on social institutions and economic action (Granovetter 1985; Hamilton and Biggart 1988; Friedman and Hechter 1988; Weakliem 1989; Campbell and Lindberg 1990; Cook and Levi 1990; England and Kilbourne 1990; Fligstein 1996; DiMaggio and Powell 1991; Friedland and Alford 1991; Lindenberg 1992; Brinton 1992; Ensminger 1992; Petersen 1993; Hopcroft 1994; Nee and Lian 1994; Smelser and Swedberg 1994; Zelizer 1994; Evans 1995; Adams 1996; Sanders and Nee 1996; Nee and Su 1996). What, then, is the new institutionalism in sociology?¹

Since its founding, sociology as a discipline has been closely associated with the study of social institutions and the comparative analysis of institutional change. Sociologists have all along argued that institutions have consequences for social and economic action. Unlike the earlier sociological institutionalism pioneered by Talcott Parsons (1937), however, the new institutionalism seeks to explain institutions rather than simply to assume their existence.² In this endeavor, new institutionalists in the social sciences generally presume purposive action on the part of individuals, albeit under conditions of incomplete information, inaccurate mental models, and costly transactions. Such conditions are common to everyday social and economic transactions.³ Although the new institutionalist paradigm rejects the basic assumptions of neoclassical economics, it remains committed to the choice-theoretic tradition of explanation in the social sciences.

The new institutionalist paradigm involves integrating the assumption of purposive action with comparative institutional analysis central to the sociological

tradition. Although rational action has long been associated with economics and psychology, the idea of context-bound rationality was also tacitly incorporated into macrosociological theory early in the development of the discipline, through the writings of Max Weber, Alexis de Tocqueville, Karl Marx, and Vilfredo Pareto. It was also assumed by an entire generation of theorists—including Talcott Parsons, George Homans, and Robert Merton—who led American sociology to prominence in the post-World War II era. Far from being threatened by the paradigm shift taking place in economics, sociology has much to gain from the new interest in producing a theory of institutions and institutional change. Sociology also has much to lose by not participating in this cross-disciplinary paradigm.

INSTITUTIONALISM IN ECONOMIC AND POLITICAL THOUGHT

Neoclassical economics argued that social relationships and institutions do not fundamentally matter—that is, do not alter fundamentally the choice-set of actors—since it assumes perfect information and stable preferences, and therefore efficiency. These basic assumptions of the neoclassical paradigm were challenged by Ronald Coase (1960) in his celebrated article “The Problem of Social Cost,” which laid the theoretical foundations for bringing institutions back into economics. Coase’s discovery that transaction costs matter provided the key insight that spawned a new interest in understanding and explaining institutions. He showed that only in the absence of positive transaction costs does the efficiency assumption in neoclassical economics hold true. Fundamentally, transaction costs pertain to the problem of trust. Informational asymmetry and uncertainty make credible commitment to agreements difficult to secure. In a world in which information is costly, different institutional environments imply differences in the credibility of commitment and hence the cost of transacting (Williamson 1975). Because transaction costs make up a significant part of the cost of production and exchange in modern economies, alternative institutional arrangements can make the difference between economic growth, stagnation, or decline (North 1981).

The new institutionalism in economics and political science has emphasized formal norms and their monitoring by third-party enforcers, the state and the firm. Coase’s essay “The Nature of the Firm” (1937) laid the foundation for the law, economics, and organizations approach in economics (Williamson 1975; North 1981). Combined with his essay “The Problem of Social Cost,” it identified the focal points for research in the new institutionalist economics. The resulting research agenda has been cross-disciplinary in scope, incorporating a focus on the state and the firm as the key institutions. Ruler and entrepreneur in their respective domains specify and enforce the formal organizational constraints that shape the structure of opportunities.

Coase (1937) argued that the firm represents an alternative governance structure to the market by providing an environment in which the price mechanism is replaced by the power and authority of the entrepreneur. The existence of the firm, Coase reasoned, implies that there are costs to market transactions. It depends on the entrepreneur’s ability to economize on costs stemming from uncertainties associated with markets. These uncertainties pertain to the costs of mea-

sure the performance of agents and of enforcing commitment to contractual agreements. Although the same agency problems are found within the firm, entrepreneurs are in a position to use their power and authority to direct employees. In Coase's firm, the employment contract is essentially the same as Hobbes's view of the relationship between citizen and state. By entering into a contract, Coase argues, the employee in exchange for remuneration agrees to comply with the orders of the entrepreneur, within certain limits. The essence of the contract, in Coase's view, is that it states only the limits of the entrepreneur's power. Within these limits, entrepreneurs can direct their employees as they do other factors of production.

The Coasian framework of transaction cost economics was extended by Douglass North to build a theory of the state based on an exchange view of the relationship between ruler and constituent, with the state exchanging protection and justice for revenue. Because the essence of property rights is the right to exclude, the state, which has a comparative advantage in violence, plays a key role in specifying and enforcing property rights. The ruler as a revenue maximizer acts "like a discriminating monopolist, separating each group of constituents and devising property rights for each so as to maximize state revenue." He is constrained, however, by the existence of potential rivals who provide the same services. North (1981) argues that institutional innovations will come from rulers because the free-rider problem limits the ability of constituents to initiate society-wide institutional change. For North, the central task in explaining economic growth is to specify the events and conditions that provide incentives for political actors to establish formal institutional arrangements supporting efficient property rights. These entail the dilution of state control over resources and the emergence of some form of political pluralism. This does not imply a weak state, but a state and society context in which the tension between ruler and constituent allows for the evolution of institutions that limit the capacity of the state to expropriate resources from producers (North and Weingast 1989).

While the new institutionalism in economics has developed theories explaining formal constraints, the subinstitutional social basis of formal institutions has been undertheorized. This is the domain of ongoing social relationships, the social matrix that comprises the basis of informal constraints. The micro-macro linkage is a central issue in the developing new institutionalist paradigm (Alexander et al. 1987). Sociology's role can profitably be to go beyond the insights from game theory to explain the connection between the subinstitutional domain of social action and concrete relationships, and the meso- and macroinstitutional domains of custom, conventions, law, organizations, ideology, and the state. This connection involves social norms that bridge the microworld of individual actors and networks, and the larger institutional framework (see Nee and Ingram in this volume).

DEALING WITH DURKHEIM'S LEGACY

The rediscovery of institutions by economists has elicited mixed responses from sociologists. This is not surprising, for sociology since the time of Auguste Comte has defined itself as an imperial discipline. This self-image was reinforced in the writings of Emile Durkheim, who sought to establish sociology in opposi-

tion to psychology and economics. Durkheim proposed a distinct sociological approach, laying the foundations for what today is identified as methodological holism. Although few sociologists now identify themselves as followers of Durkheim, his intellectual legacy persists through the continuing influence of his methodological contribution. In contrast to methodological individualism, which assumes that the social order is a product of the aggregation of individual actions, methodological holism assumes that the social order cannot be reduced to the behavior of individual actors. Its mode of analysis starts with the specification of the “social facts” or structures that, it is posited, constitute the building blocks of the social order.⁴ From the vantage point of strict methodological holism, the relationship between individuals and society can be metaphorically compared to that between leaves and the tree. Leaves come and go according to the seasons, but it is the tree’s branches and trunk that over the years shape their pattern and distribution. In this view, individual action is likened to the fluttering of leaves in a breeze.

Despite the enduring legacy of Durkheim’s methodological influence, his perspective is not synonymous with the sociological approach, as some insist. Many sociologists underestimate the important representation of methodological individualism in macroscopic studies in sociology. From Tocqueville’s analysis of the French Revolution and Weber’s seminal study of Protestant sects in the rise of capitalism in the West to contemporary studies of development, social movements, and social mobility, the idea of rational action bounded by institutions—cultural beliefs, myths, custom, norms—has been effectively utilized in explaining macrosociological phenomena. As Raymond Boudon (1987, 64) remarks:

On the whole, if the various theoretical reflections of Weber, Pareto, and others on the theory of social action were systematized and combined with the implicit theory of action incorporated in the many studies using the individualistic paradigm, the main idea that would emerge from such an inventory might be the notion of *context-bound rationality*. In the individualistic sociological tradition individual action is considered rational, but this rationality can take various forms as a function of the context. The actions of the social actors are always in principle *understandable*, provided we are sufficiently informed about their situation.

The reciprocal interactions between purposive action and social structure were addressed at least implicitly in the earlier American sociological institutionalism. Robert Merton ([1949] 1968) maintained that social structure operates both as a constraint on behavior and as a structure of opportunity that facilitates or inhibits social action. Although Merton did not specify the mechanisms through which social structure mediated choice, he nonetheless assumed that choice between socially structured opportunities was central (Stinchcombe 1975). Similarly, in a previously unpublished essay written in 1934, Talcott Parsons (1990) contended that a theory of institutions must incorporate the rational action of individuals. Parsons recognized the importance of positive and negative sanctions, but he subordinated these social mechanisms to what he perceived to be a more fundamental cement of society: its ultimate values. Although neither Merton nor Par-

sons developed a theory of institutions, they recognized that this was of central importance to sociology as a discipline. Likewise, they saw that a theory of institutions needed to incorporate agency, conceived as the outcome of choices by individual actors.

George Homans (1950) thought of the causal relationship between individual action and social structure as one of mutual dependence. In his view, the problem with Durkheim's "social mold" theory was that it left out individual agency. Socially isolated individuals may be more at risk of committing suicide, but the act of suicide is an individual decision. Not everybody in similar social circumstances commits suicide. Mutual dependence is the underlying assumption of the rapidly growing literature integrating network analysis with social exchange theory (Cook et al. 1983); it is also the insight motivating the concept of structuration (Giddens 1984; Sewell 1992). As Douglas Heckathorn (1997) proposes, rather than argue over the relative merits of methodological individualism or holism, a more constructive approach is to model the reciprocal interactions between purposive action and social structure. Heckathorn demonstrates formally that game theoretic models can be specified both at the individual and group levels, decisively blurring the distinction between methodological individualism and holism.

Although the idea of context-bound rationality has appeared at least tacitly in sociology since the founding of the discipline, models of rationality and rational choice have meanwhile progressed considerably in economics, especially through advances in game theory. Game theory is a standard tool used to analyze multi-person decision problems (Gibbons 1992). In game theory, actors are engaged in strategic interactions with others, as exemplified in the well-known prisoner's dilemma game. This game and variations of it have been employed to dissect the choice-set of actors caught in common social dilemmas (Hardin 1982). Game theory provides deep insights on the dynamics of choices within constraints but does not provide a theory of the constraints, which is where sociology fits in. What sociology has to offer is an integrated framework of the totality of societal relations. The literature of sociology is a rich storehouse of theoretical and empirical findings that pertain to the constraint side of the choice-within-constraint framework of analysis emphasized by Durkheim.

CLASSICAL SOURCES OF THE NEW INSTITUTIONALIST PARADIGM

The tradition of comparative institutional analysis established in the classical and modern periods of sociology provides an appropriate foundation for the new institutionalist approach in sociology. Of the classical theorists, Max Weber's ([1922] 1968) *Economy and Society* perhaps best exemplifies the sociological approach to comparative institutional analysis. This work grew out of *The Outline of Social Economics* series Weber edited, which brought together contributions by prominent social scientists of the time on topics from institutional economics and sociology (Roth 1968). Although Weber was a sociologist, his institutional theory drew liberally from economics. As Randall Collins (1980, 928) observes, Weber's conception of the market was virtually indistinguishable from that of neoclassical economists:

He sees the market as providing the maximal amount of calculability for the individual entrepreneur. Goods, labor, and capital flow continuously to the areas of maximal return; at the same time, competition in all markets reduces costs to their minimum. Thus, prices serve to summarize all the necessary information about the optimal allocation of resources for maximizing profit; on this basis, entrepreneurs can most reliably make calculations for long-term production of large amounts of goods.

In *Economy and Society*, Weber developed concepts, definitions, and typologies that he employed in a comparative historical analysis of law, organizations, and economic action. In effect, he pioneered the context-bound rationality approach in sociology. He maintained that rationality and choice must be understood within the context of the institutional framework of a given society and historical epoch. For Weber, the institutional framework encompassed customs, conventions, social norms, religious and cultural beliefs, households, kinship, ethnic boundaries, organizations, community, class, status groups, markets, law, and the state. His ideal-type and comparative methodology specified historically grounded concepts that identified institutional forms with distinct structures of power and opportunity. As demonstrated by Hamilton and Feenstra (in this volume), Weber offers a rich storehouse of theoretical contributions that can be fruitfully used in the new institutionalist research program.

Like Weber, Karl Marx also borrowed extensively from economists, particularly from Adam Smith and David Ricardo, so much so that the economist Paul Samuelson dismissed Marx as a “minor post-Ricardian” (Elster 1985). This, combined with the sloppiness of Marx’s scholarship in *Capital*, led North (1986) to pose the question, “Is it worth making sense of Marx?” In his answer, North credited Marx with foreshadowing the concept of transaction cost in exploring the tension in the relationship between production and the forces of production.⁵ What set Marx apart from neoclassical economics, in North’s assessment (1981, 61), was an integrated perception of the totality of societal relations:

The Marxian framework is the most powerful of the existing statements of secular change precisely because it includes all of the elements left out of the neoclassical framework: institutions, property rights, the state, and ideology. Marx’s emphasis on the crucial role of property rights in efficient economic organization and on the tension that develops between an existing body of property rights and the productive potential of a new technology is a fundamental contribution. It is technological change that produces the tension in the Marxian system; but it is through class conflict that change is realized.

Marx’s influence on the new institutionalist paradigm is manifest not only in economic history but in analyses that focus on societal governance structures in which the state plays a decisive role in establishing the pattern of property rights (Bates 1989; Campbell and Lindberg 1990; Evans 1995).

Karl Polanyi ([1944] 1957) was closely associated with the “substantivist school,” which sought to develop an alternative economic analysis to the formalism of the neoclassical paradigm. Polanyi’s writings took on a distinct antimarket

bias, as reflected in his characterization of the unregulated market as a satanic mill ravaging the social and cultural fabric of society. His ideal-types of non-market and market institutional forms greatly overstated the distinction between social and economic goals. In the same vein, Polanyi overstated the extent to which embeddedness applied to archaic markets and understated the extent of embeddedness in modern markets (Granovetter 1985). Despite these limitations, Polanyi's enduring contributions to the new institutionalist approach are his insight that the state plays a decisive role in the construction of the "unregulated market" and his concept of embeddedness; these in essence are consistent with the idea of context-bound rationality.

Parallels with Parsons's Institutionalism

Parsons sought to synthesize the institutionalist ideas associated with Emile Durkheim, Max Weber, Vilfredo Pareto, and Ferdinand Tönnies into a framework for modern sociology. The recent publication of "Prolegomena to a Theory of Social Institutions," written in 1934, shows that he regarded the construction of a theory of institutions as the central project for sociology. His outline there of a theory of institutions foreshadowed central themes in the new institutionalist paradigm. The idea of choice within institutional constraints is clearly specified in his observation that "the very concept of rational choice, pushed beyond the 'technological' application of means for a single end, to the case where there is also a choice of ends involved, has no meaning unless it is thought of in terms of an organized *system* of ends" (323, italics in original). He conceived of the institutional framework as an organized system of cultural beliefs—norms—common to most individuals composing a society. He argued that it is rules and values that constitute an institution, not the concrete pattern of behavior or social relationships. He maintained that rational action in "conformity with these norms, does not follow automatically from the mere acceptance of the ends as desirable" (325). And he viewed institutions as giving rise to socially structured interests, and hence to an organized system of incentives. It is useful to quote Parsons at length for his conception of how institutions structure interests:

It is not to be supposed that the fact that it is to the personal advantage of the members of a community to conform to its institutional norms is proof that these norms depend primarily or exclusively on interest and sanctions for their effective enforcement. For the very strength of the moral attachment of the community to these norms will on the one hand tend to canalize interests in conformity with them. Thus the principal personal rewards, above all in social esteem, will tend to go to those who do conform with them. On the other hand, the same strength of moral attachment will tend to visit disapproval and sometimes overt punishment on those who violate them.

But this very fact, of fundamental importance, means that, once really established, a system of institutional norms creates an interlocking of interests, both positive and negative, in its maintenance, and to a certain point its supports in the form of moral attachment may dissolve away and still leave it standing supported by the complex of interests, ultimately of sanc-

tions since once positive interests are diverted from conformity only sanctions can take their place.

North (1981, 185) acknowledges Parsons's "pioneering effort to come to grips with many of the issues" central to the new institutionalist paradigm. According to North, the problem with Parsons's institutionalism was that he failed to solve the free-rider problem and to produce a coherent theory of institutions. Coleman (1990b) makes essentially the same criticism in his commentary on Parsons's "Prolegomena" paper.⁶ Coleman asserts (p. 327) that the failure of Parsons's "pioneering effort" to produce a theory of institutions has served to clarify what a theory of institutions must explain. A theory of institutions must specify the causal mechanisms through which norms and rules are produced and maintained.⁷ It must explain the relationship between informal and formal regulatory norms. And it must explain institutional change. Related to this, a theory of institutions should address the question of how differences in cultural beliefs give rise to different institutional structures. These issues motivating research in the new institutionalist paradigm are taken up, in this volume, by Nee and Ingram; North; Ellickson; Greif; Knight and Ensminger; Brinton and Kariya; Ingram; and Hopcroft.

INSTITUTIONS AS A FORM OF CAPITAL

At the theoretical center of the new institutionalist paradigm is the concept of choice within constraints. Institutions, defined as webs of interrelated rules and norms that govern social relationships, comprise the formal and informal social constraints that shape the choice-set of actors. Conceived as such, institutions reduce uncertainty in human relations. They specify the limits of legitimate action in the way that the rules of a game specify the structure within which players are free to pursue their strategic moves using pieces that have specific roles and status positions. Norms are implicit or explicit rules of expected behavior that embody the interests and preferences of members of a close-knit group or a community. The institution of modern marriage, for example, encompasses social norms governing sexual conduct (monogamy), child-rearing (shared responsibility), property rights (equal), conflict, dissolution, and, upon divorce, the custody of children. The informal norms are monitored by family members, relatives, friends, and acquaintances, while the legal rules are formally monitored by the state. Insofar as norms help solve the problem of coordination and collective action, they enable actors to capture the gains from cooperation, which, in the case of marriage, entails sharing and thus lessening the costs of bearing and rearing children.

The idea of norms as a form of capital was first alluded to by Homans ([1961] 1974, 361) as "a moral code, especially a code supporting trust and confidence between men: a well-founded belief that they will not always let you down in favor of their private, short-term gain." Conformity to norms of a social group is what renders the norm a form of capital. Because norms are collectively maintained, and benefits gained by conforming are shared by members of the group, norms amount to a collective good (Coleman 1990a). An emphasis on norms as cultural beliefs that constrain opportunism distinguishes the new institutionalist

approach from the instrumental view of network ties, which sees actors using their social ties to achieve private gain beyond that which could be obtained through their stock of human capital (Lin 1982). As in the network definition of social capital, individuals derive benefits from the norms, but such benefits are realized at the cost of short-term private gain by opportunists. In other words, norms become social capital to the extent they are able to solve social dilemmas that would otherwise result in suboptimal collective outcomes caused by individuals pursuing private advantage at the cost of collective goods. The idea of norms as social capital was given a stronger theoretical basis in Robert Ellickson's "welfare maximizing" hypothesis (1991, 167) for workaday norms: "*Members of a close-knit group develop and maintain norms whose content serves to maximize the aggregate welfare that members obtain in their workaday affairs with one another*" (italics in original). Consistent with Ellickson's hypothesis is the theory of social norms that builds on the proposition that *individuals jointly produce and uphold norms to capture the gains from cooperation* (Nee and Ingram in this volume).

The conception of norms as social capital has the advantage of making it possible to derive consistent predictions of their effects on individuals and group performance (Homans [1961] 1974; Ellickson 1991; Nee and Ingram in this volume). This allows social capital to be put on an analytical footing similar to that of other forms of capital. Human capital theory predicts a positive effect of education and work experience on an individual's income returns (Schultz 1961). Similarly, the workaday norm of a close-knit group can be expected to enhance the welfare of members who conform to the norm, by solving the problem of coordination and collective action. To be sure, zealots can induce a state of overconformity, resulting in negative effects on members of the group (Coleman 1990a). Overconformity is seen, for example, in religious cults, where it can produce such collective tragedies as the Jonestown and Heaven's Gate mass suicides. Such extreme examples of overconformity are uncommon, however. Generally, conformity to norms of a group produces a form of cooperation needed to achieve collective goods that otherwise could not be realized by individuals on their own in pursuit of private advantage. As noted, by constraining short-term private gains, norms facilitate cooperation that in turn enables actors to realize long-term benefits. It is in this sense that norms (and other cultural beliefs) constitute forms of capital. In sum, the social processes that give rise to conformity are causal mechanisms that enable cooperation to be sustained, and these in turn convert the norm into fungible capital realized by means of group performance.

The social mechanisms *through which* social norms are produced and maintained, not the norms themselves, give rise to social order. Informal norms are monitored by means of sanctions as common as social approval and disapproval, the by-products of social interactions in close-knit groups (Homans [1961] 1974). Universal preference for approval and aversion to ostracism contribute to maintaining the norms of a group. Formal rules are produced and maintained by such organizations as the state and the firm. When formal organizational rules are in conflict with interests and preferences embedded in social norms, customs, and conventions, they are costlier to monitor. On the other hand, when formal and informal norms are congruent, the monitoring of formal organizational rules is assumed to a larger extent by individual members of small groups and close-

knit communities. This latter condition results in lower costs of monitoring and enforcement.

CONTEXT-BOUND RATIONALITY

The new institutionalist paradigm rests firmly within the choice-theoretic tradition. This raises the question of the place of rational choice theory in the new institutionalist sociology. Basic assumptions of rational choice theory become less and less tenable the more institutions are taken into account in causal models (see North, in this volume). In contrast to “thin” accounts of rational choice (Becker 1976; Coleman 1990a), the idea of context-bound rationality assumes a “thick” view of rationality. But this thick conception does not imply abandoning the assumption of rational action. As Herbert Simon (1957, xxiv) put it, humans are “intendedly rational, but only limitedly so.” Although in this conception actors are seen to *meliorize* rather than maximize, the action of individuals is assumed to be purposive in the sense that self-interest and incentives matter. In thick accounts of rationality, understanding purposive action necessitates interpreting the choices made by actors according to benefits and costs embedded in the institutional environment.⁸ The cultural heritage of a society is also important because custom, myths, and ideology matter in understanding the mental models of actors. For example, Jews and Arabs in Jerusalem employ sacred and profane symbols in defending collective identities and ethnic boundaries. It is thus impossible to understand the pattern of ethnic conflict in Jerusalem without examining the cultural beliefs and symbolic expressions of Arabs and Jews (Friedland and Hecht 1996).

As North remarks in his Nobel Prize acceptance speech (in this volume) pointing to the significance of recent breakthroughs in cognitive psychology for economics:

It is necessary to dismantle the rationality assumption underlying economic theory in order to approach constructively the nature of human learning. History demonstrates that ideas, ideologies, myths, dogmas, and prejudices matter; and an understanding of the way they evolve is necessary for further progress in developing a framework to understand societal change. The rational choice framework assumes that individuals know what is in their self-interest and act accordingly. That may be correct for individuals making choices in the highly developed markets of modern economies, but it is patently false in making choices under conditions of uncertainty—the conditions that have characterized the political and economic choices that shaped (and continue to shape) historical change.

Context-bound rationality is not inconsistent with other formulations of rational action that have moved beyond the limits of rational choice theory. For example, the concept of emergent rationality extends evolutionary game theory to posit a backward-looking notion of rationality in which rules embody past experience of successful or rewarding adaptation (Macy 1997). Rather than calculating the future consequences of alternative sets of action, actors rely on rules of thumb and established routines. Both concepts assume limited cognitive ability on the part

of actors. However, emergent rationality emphasizes adaptation based on unintended consequences of action not intentionally rational. Hence, actors may appear smarter than they are in following rules that have evolved through trial-and-error adaptation to the environment.

Central arguments in organizational new institutionalism are not inconsistent with context-bound rationality if actors are viewed as organizations. According to this interpretation, organizations conform to institutionalized myths to enhance their legitimacy and stability, and this promotes success and survival (Meyer and Rowan 1977). Because myths are external to the organization and do not emerge from the technical requirements of coordination and control, they often are at odds with the efficient execution of the organization's practical tasks. Consequently, although organizations behave rationally in conforming to the rules and expectations of the institutional environment, in doing so they construct an institutional environment that constrains their ability to change further (DiMaggio and Powell 1983).⁹ The result is conformity but often without gains in efficiency in the aggregate. However, Meyer and Rowan (1977) predict that when myths and ceremonial functions are inconsistent with efficiency, organizations will decouple formal rules from their practical activities and comply with institutionalized myths ritualistically. Thus interpreted, the legitimacy/conformity story is clearly consistent with the mutual dependence of action and structure that is central to the idea of context-bound rationality.

A deepening interest in the implications of "thick" rationality for a theory of action provides an opening for intellectual trade between institutional theorists in organizational analysis and other new institutionalists. For new institutionalist sociology, the gain from trade with economics is an action theory that solves the problem of intentionality and interest posed by DiMaggio and Powell (1991). As Neil Fligstein (1996b, 397) remarks, organizational new institutionalism "has a limited theory of action because it generally focuses on how meanings become taken for granted." For economics, the gain is access to the theoretical and empirical findings specifying causal mechanisms at the organizational and environmental levels.

CONCLUSION

Methodological holism in sociology has been an obstacle to acceptance of the choice-theoretic approach underlying the new institutionalist paradigm. A consequence of this impasse has been sociology's growing isolation from allied social science disciplines at a time when rapid progress is being made in understanding and explaining the microfoundations of the social order. This need not be the case, because much of classical and modern sociology has sought to integrate utilitarian and structural accounts into a macrosociological theoretical framework. Indeed, a form of methodological individualism represents the mainstream of modern empirical sociology. It is this heritage that the new institutionalism in sociology seeks to build on. Periods of ascendancy in sociology have often followed open trade and engagement with economics. Rather than attempting to show how sociology relegates economics to the intellectual dustbin, the new institutionalism in sociology pursues a tack that is more consistent with the classi-

cal period of sociology. In this respect, the new institutionalist approach may be viewed as a neoclassical turn in sociology. The new institutionalism in sociology extends the intellectual legacies of classical sociologists and earlier sociological institutionalists who similarly engaged in productive intellectual trade with economics.

Sociology as a discipline has specialized in the study of humanly devised constraints. Although sociology does not have a theory of choice, it has pioneered a rich array of theoretical and empirical research on formal and informal constraints, their effects on individuals and organizations. From social exchange theory and network analysis to studies of organizational ecology and institutional environments, there is in sociology a growing accumulation of theory and evidence that pertain to the constraint side of the choice-within-constraint framework of analysis.

Until recently, however, sociologists have assumed but not explained the existence of constraints. Yet, as choice theorists have argued, the key to understanding and explaining large-scale collective action, the emergence of institutional structures, and the dynamics of institutional change—all issues of central interest to sociologists—resides in solving the free-rider problem (Olson 1965; North 1981; Hardin 1982). Recognition of the difficulty of doing this from within the explanatory framework of methodological holism has led sociologists to consider choice-theoretic arguments (Homans [1961] 1974; Coleman 1990b). But such pioneering efforts have stopped short of incorporating institutions into a coherent theoretical approach. Reformulating classical themes in sociology within a choice-theoretic framework—of context-bound rationality—opens the way to solving the free-rider problem while retaining the focus on institutional structures central to sociology.

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NOTES

1. Institutional theory is the most influential paradigm in sociological studies of organizations (Scott 1981; DiMaggio and Powell 1991). Sociologists often refer to this literature as the new institutionalism in sociology. This chapter is not about institutional theory in organizational analysis, although I do point out areas of convergence.
2. This is not as true of institutional theory in organizational analysis. Meyer and Rowan (1977), for example, assume the existence of myths. Organizational institutionalists are interested in studying the effect of isomorphic processes on organizations.
3. For example (to consider only one source of informational asymmetry), individuals calculate strategically to impose a definition of a situation that is in accord with their interests, and their behavior is frequently misunderstood by others, as Erving Goffman (1965, 6) observes:

Sometimes the individual will act in a thoroughly calculating manner, expressing himself in a given way solely in order to give the kind of impression to others that is likely to evoke from them a specific response he is concerned to obtain. Sometimes the individual will be calculating in his activity but be relatively unaware that this is the case. Sometimes he will intentionally and consciously express himself in a particular way, but chiefly because the tradition of his group or social status require this kind of expression and not because of any particular response (other than vague acceptance or approval) that is likely to be evoked from those impressed by the expression. Sometimes the traditions of an individual's role will lead him to give a well-designed impression of a particular kind and yet he may be neither consciously nor unconsciously disposed to create such an impression. The others in their turn, may be suitably impressed by the individual's efforts to convey something, or may misunderstand the situation and come to conclusions that are warranted neither by the individual's intent nor by the facts.

Goffman's microanalysis of social action indicates that actors engage routinely in strategic interactions modeled by game theorists. I am indebted to Neil Fligstein for this observation.

4. Institutional theory in organizational analysis is methodologically holist and rooted in Durkheim and the more phenomenological side of Weber through the influence of Alfred Schutz and Peter Berger and Thomas Luckmann. According to Meyer and Rowan (1977), in modern societies institutionalized rules "function as powerful myths." Such myths, defined as "classifications built into society as reciprocated typifications or interpretations," exercise an important causal effect on the formal structure of organizations and on their ability to survive. Myths become, in effect, the building blocks of formal organizational structures because "organizations must incorporate them to avoid illegitimacy." As extant myths are extended or new myths arise, defining "new domains of rationalized activity," existing organizations expand their formal structures accordingly and/or new organizations emerge.
5. The problem with Marx, according to North, is that he did not have a theory of the rate of technological change and that his overall theory put too much weight on the efficacy of class as the primary unit of action. Class assumes a community of interest when, in reality, conflicting interests exist within classes. Moreover, Marx's idea of class overlooked the free-rider problem. In other words, collective action in large groups is difficult to mobilize in the absence of selective incentives (Olson 1965). Because public goods are by definition nonexcludable, individuals have an incentive to "free ride" on the contributions of others.
6. According to Coleman, what led Parsons astray was the functionalist fallacy: "A serious fault in the theoretical structure that Parsons established in 'Prolegomena' is his failure to show how, and to define the conditions under which, the interest in or 'need for' an institutional norm actually results in the establishment of an institution" (336). Coleman also faulted Parsons for a *reductio ad absurdum* in claiming that action can be treated as social insofar as actors share common values.
7. Coleman emphasizes the need to explain the actual emergence of norms and institutions. This emphasis is misplaced, however, because the emergence of norms occurs mainly as an *ad hoc* process characterized by trial and error (Shibutani 1978). I am indebted to Russell Hardin on this point.
8. Purposive action is implicit in accounts of institutions viewed as constraints and opportunities (see Hamilton and Feenstra; Frank; Hopcroft; Western; and Széleányi and Kostello in this volume).
9. DiMaggio and Powell examine isomorphic institutional processes in order to account for the "startling homogeneity of organizational forms and practices." They explain this homogeneity as the outcome of three isomorphic mechanisms—coercive, mimetic, and normative—in the institutional environment. Organizations conform to political rules enforced by the state, mimic successful organizations in response to uncertainty, and comply with rules of professionalism fostered by schools and associations.

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