Introduction: The Institutions of the Market

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0.1. Overview

What defines the institutional specificity of markets? Which factors drive the interaction among market actors? How are markets governed? Questions like these belong to the standard repertoire of the social sciences. Certainly, this is because markets are defining institutional characteristics of economies and societies in modern capitalism. Addressing the institutional substance of markets, however, is a particularly relevant motivation for the theoretical perspective of the new institutionalism in the social sciences. Indeed, recent advances of institutionalist theorizing in economics, sociology, and political science have been concerned with the exploration of markets as specific institutional ensembles. As such, markets are part of a diversity of governance mechanisms alongside hierarchies, networks, and related hybrid forms of social coordination. The institutional dynamism of markets is accordingly derived from a variety of interrelated determinants. These include the organizational capabilities of firms as market actors, their competitive interactions in the market process as well as the governance of their market relations.

The following chapters address these aspects as a representation of the institutions of the market, viewed in the context of theoretical advances in the current debates of the new institutionalism. In focusing on the organizational, competitive, and regulative dimensions of markets, the presentation in the chapters is primarily concerned with contributions from organization studies, institutional economics, economic sociology, and institutional political economy. The underlying thesis suggests that
the basic conceptual parameters of the new institutionalism are currently shifting towards an integrative framework that adheres to evolutionary concepts in accounting for the matter of knowledge, learning, and institutional change. Organizational dimensions of market operations are taken to the fore regarding their endogenous capabilities, systemic interactions, and governance relations. An evolutionary perspective thus may contribute to a profoundly dynamic understanding of the institutions of the market.

0.2. The Institutions of the Market and the Varieties of Institutionalism

A consensual characterization of the new institutionalism in the social sciences invokes a common understanding of institutions as sets of rules and norms that contribute to the evolution of social systems of governance, involving markets as institutional ensembles. The underlying research perspective addresses institutional diversity as a result of complex interactions in the formation and transformation of institutions (Morgan 2005; Nee 2005). Accounting for this quality of institutional change, then, a complementary definition of institutions in game theoretic terms would highlight their attributes as systems of shared beliefs about a salient way a particular game is played. This allows for reconsidering the contested character of institutions as social constructions (Aoki 2001: 10–12). Applied to the matter of markets, this means that the market process of coordinating supply and demand may be viewed as a set of games that proceed in the framework of specific rules and norms. More specifically, markets provide the terrain for transactions among autonomous actors who engage in decentralized bargaining based on contractual arrangements and price signals. This horizontal mode of coordination is well contrasted with vertical coordination in organizational hierarchies as well as with hybrid coordination in networks. However, considering the actually existing variety of markets for diverse commodities, the coordination of market processes is subject to a diversity of competitive patterns and regulation modes beyond the price mechanism (Boyer 1997; Hollingsworth and Boyer 1997: 7–9). Accordingly, the new institutionalism dispenses with the institutional sterility of the neoclassical definition of markets as decentralized allocation mechanisms. By adding institutional substance to this definition, analytical attention is directed to the organizational capabilities of the involved actors as well as to the attributes of their interactions. For that reason, aspects like rationality and efficiency play a prominent role in delineating the various strands of institutionalist reasoning.

Indeed, critical assessments of rational choice theory serve as a point of reference for demarcating the major lines of reasoning in the new institutionalism. Viewed in terms of distinct levels of analysis, rational choice institutionalism may be assessed according to its micro-focus on the incentive effects of rules and norms in governing exchange relations. This is differentiated from organizational institutionalism with its meso-focus on role-following behavior in organizational fields and populations as well as from historical institutionalism with its macro-concern for the path-dependent change of political–economic governance structures (Campbell 2004: 2–3). Alternatively, in reconsidering their theoretical foundations, these major strands of institutionalist reasoning may be positioned in a continuum of ideas that range from ‘calculus’ to ‘cultural’ views on the behavioral impact of institutions. The calculus perspective claims that institutions reduce uncertainty in strategic interactions, whereas the cultural perspective addresses the institutional framing of individual rationality (Hall and Taylor 1996).

Rational choice institutionalism stands for the calculus position, which is rooted in the new institutional economics. It models institutions as instrumental outcomes of individual maximization strategies that apply to market processes as well as to politics, bureaucracy, and other domains of social coordination. In this framework, problems of monitoring and enforcement that arise from the transfer of property rights are to be solved through institutional incentives (Furubotn and Richter 1997). A major contribution to this line of reasoning is Oliver Williamson’s transaction cost theory of economic organization. It highlights contractual arrangements, which economize on transaction costs that arise from the costliness of information in exchange (Williamson 1985, 2000). The latter aspect is taken up in Douglass North’s theory of institutional change. It applies the transaction cost perspective to the evolution of property rights in economic development. Institutions are defined as legal rules and social norms that govern both economic and political exchange. Their path-dependent change shapes the institutional profile of cultural evolution (North 1990, 2005). In its characterization of markets, thus, rational choice institutionalism perceives market operations as strategic interactions in a competitive setting. Their dynamism underlines the comparative inertia of political institutions (Shepsle 2001). However, despite the increasing openness of rational choice institutionalism for
aspects of context-specificity, bounded rationality, and institutional inefficiency, it still struggles with the recombination of its basic components; suffice to mention the problem of functionalism in the interpretation of institutional change.

Organizational institutionalism represents the cultural counterpart to the calculus framework of the rational choice approach. It highlights institutions as culturally embedded social constructions, an interpretation that applies also to markets as distinct institutional ensembles. Because of a contextual ‘logic of appropriateness’, institutions are related to cultural scripts and aspects of legitimation that promote role-following behaviour in an organizational context. In this manner, an integrated cultural-cognitive perspective on organizational interactions is taken to the fore (DiMaggio and Powell 1991; March and Olsen 1989). In particular, organizational institutionalism addresses the matter of identity, legitimation, and symbolism in explaining the isomorphic change of organizational patterns. This resounds arguments of classical sociology that cope with the cultural determinants of social interaction. Thus, the organizational behaviour of market actors is not subject to an instrumental calculus but rather to the perception of cultural appropriateness (Scott 2001: 51–2). The latter proposition hints at a major criticism of rational choice institutionalism. Above all, its implicit assumption of institutional efficiency is said to neglect the attributes of organizations as ‘power systems’ (Zafirou 2004: 372–3). However, organizational institutionalism suffers from analytical deficits as well. Above all, its implicit tendency of cultural determinism in theorizing organizational behaviour also neglects factors such as interest, power, and conflict.

An intermediate position between both the calculus and the cultural perspectives that delineate the theoretical discourse of the new institutionalism is provided by historical institutionalism. Emerging from institutional political economy, it relates institutions to the diversity of political-economic governance structures. The corresponding focus of attention is directed at legal rules and formalized norms, which are subject to strategic compromises in institutionalized bargaining procedures (Streeck and Thelen 2005: 10–11). In this vein, the perspective of historical institutionalism approaches markets as creations of government, which are embedded in distinct sets of social and political institutions. Market regulation thus belongs to its centre of attention (Immergut 1998; Reich 2000). Because of this concern with the relationship between market and state, the national diversity of political-economic governance regimes stands out as a research issue. Varieties of capitalism are derived from the organization of the private sector, which implies a reconsideration of the relational set-up of firms in a specific institutional environment (Amable 2003; Hall and Soskice 2001; Streeck and Thelen 2005). This allows for countering mechanistic perceptions of the market. Instead, historically rooted institutional modes of economic and social coordination are addressed as factors in shaping distinct trajectories of economic development (Boyer and Saillard 2002; Zysman 1994). Still, related to this implicit focus on developmental continuity, historical institutionalism is not fit to adequately grasp the matter of institutional innovation and rapid change. Therefore, it seems that an integrated framework is required to transcend the self-imposed analytical limitations of the new institutionalism.

0.3. Understanding Institutional Change: Towards an Integrated Framework

Recent trends in the differentiation of institutionalist theorizing are related to the analytical challenge of understanding institutional change. This differentiation reaches across the boundaries of rational choice, organizational and historical institutionalism. It also transcends disciplinary subdivisions. One example is the discursive strand of reasoning, which highlights the communication of ideas about legitimate political-economic action (Campbell and Pedersen 2001: 6; Schmidt 2006). This particular variant of institutionalist reasoning may be associated with another development in the new institutionalism, namely, an increasing acceptance of the context-specificity of individual and collective choices as a point of departure for cross-disciplinary convergence (Katznelson and Weingast 2005: 15–16). However, further suggestions address the theoretical portfolio of the new institutionalism. In particular, they highlight the need to include more explicitly the major strands of heterodox economic thought, primarily the Veblenian blend of institutionalism and Schumpeterian evolutionary economics (Nielsen 2001: 507–10).

In the light of these concerns, understanding institutional change poses the main problem of recent institutionalist theorizing. This involves questions of structure and agency in the creation and diffusion of institutions across diverse governance structures. Particularly relevant are non-equilibrium conceptions of institutions that allow for both spontaneity and design in institutional evolution (Scott 2001: 193–5;
Streeck and Thelen (2005: 19; Peters 2005: 161–2). Accordingly, theoretical developments in the new institutionalism proceed towards positions that reject the pitfalls of mechanistic functionalism in favour of a non-deterministic perspective on institutional change. Above all, the matter of learning and innovation, which is a prominent feature of evolutionary strands of institutionalist theorising, has been gaining further influence.

These conceptual reconstructions are most obvious in the discourse of rational choice institutionalism, and here especially in the new institutional economics. Claims of institutional efficiency have been largely abandoned. Instead, the path-dependence of institutional evolution is taken to the fore, highlighting increasing returns, lock-in effects, and multiple equilibria. Bounded rationality and diverging social interests are held responsible for the prevalence of inefficient institutional constellations, which are particularly relevant in the case of rules and norms that promote market exchange (Greif 1998; North 1990, 2005). This view on bounded rationality and path-dependence allows for the reconsideration of role-following behaviour in the market operations of organizations, thus offering references to sociological positions (Nee 1998: 10–11). Moreover, related to these concerns, the complex relationship between markets and states is reinterpreted in a manner that accounts for the institutional variety of governance mechanisms (Chang 2002).

In a similar manner, organizational institutionalism has been shifting its theoretical outlook towards an evolutionary perspective. Above all, this hints at organizational ecology with its specific interest in the disposition of evolving populations in institutional fields. Yet also the broader spectrum of evolutionary economics has been gaining ground (Hirsch 1997: 1716–17; Scott 2001). This tendency is accompanied by persistent references to the integration of structure and agency as a key concern for institutionalist theorizing. Indeed, in analysing the dynamism of markets, both context and choices need to be taken into account. Crucially, context is shaped not only by market forces but also by regulatory and normative pressures emanating from the public sphere (Greenwood and Hinings 1996: 1023–5). This reconsideration of the mutually constitutive interaction between organizations and their environment also allows for the matter of interest, power, and conflict. For instance, institutional innovations may be assessed as contested projects of entrepreneurial actors (Colomy 1998).

Historical institutionalism stands out in combining the recognition of evolutionary patterns of institutional change with the exploration of conflicting interests and their political-economic articulation. Agency and conflicts of interest remain decisive, for they inform the distinction between equilibrium order and historical processes (Clemens and Cook 1999; Thelen 1999). Accordingly, the concept of path-dependence has been transferred from the evolutionary segments of institutional economics. It refers to self-reinforcing social processes in historical time, which implies a reconsideration of contingent events and their lock-in effects in the evolution of the market system. Yet in the setting of historical institutionalism, the analytical emphasis is more explicitly on the aggregate impact of power relations and legitimization strategies (Mahoney 2000; Pierson 2000a; Streeck and Thelen 2005: 8–9). Adding to this amalgamation of theoretical positions, historical institutionalist reasoning on the social embeddedness of market operations goes well together with the matter of organizational learning in evolutionary economics (Coriat and Dosi 1998).

A striking example for this hybridization of theoretical perspectives in the new institutionalism is provided by recent debates in economic sociology. Indeed, it has been claimed that economic sociology covers the middle ground between the new institutional economics with its choice-theoretic framework and organizational sociology with its emphasis on cultural scripts (Nee 2005: 63–5). The theoretical matrix of economic sociology thus contains components of all the major variants of the new institutionalism. It addresses the social embeddedness of economic action by highlighting norms and routines as coordination devices while accounting for the impact of power relations in the formation of social structures (Beckert 2002: 291–2; Dobbin 2004). Yet owing to this eclecticism, there exists no consensus on the institutional substance of these structures. Following Granovetter, they may be perceived in terms of social networks, which reflect the embeddedness of market operations in a non-market setting of cultural and political influences (Granovetter 1985, 2002: 36, 2005: 34–5). Arguing against such a focus on personal relationships, Swedberg underlines the quality of institutions as manifestations of social interests. This corresponds to a Weberian interpretation of market competition as a struggle of conflicting interests (Swedberg 2005a: 6, 2005b: 243–4). However, despite these controversies, the reconsideration of evolutionary positions has been persistently moulding the research programme of all the major strands of economic sociology (Smelser and Swedberg 1994).
and schemes of legitimation (Garud, Hardy, and Maguire 2007: 957–8). Accordingly, an evolutionary perspective that represents the matter of innovation in an adequate manner reaches beyond the concepts of path-dependence and embeddedness. Institutional innovation then resembles the entrepreneurial recombination of a local institutional repertoire that exhibits both an enabling and constraining influence on the process of change (Campbell 2004: 68–70; Crouch 2005: 17, 72).

Furthermore, the developmental character of the institutional evolution of markets needs to be specified. At this point, the widespread argument of efficiency in market competition becomes decisive. An institutionalist perspective takes the trade-off between efficiency and effectiveness to the fore, confronting the static concerns of Pareto optimality in resource allocation with the evolutionary survival and control of market organizations (Fligstein 2002: 66–9). The question is, however, how far is market competition to be understood as an efficiency-enhancing evolutionary mechanism. The latter view is still widely shared in institutionalist reasoning. It is usually accompanied by the claim that evolutionary explanations of institutional change would emphasize the efficiency of competitive selection (Ingram and Clay 2000: 527; Schaprio 1997: 20). Concurrently, despite the well-established interpretation of path-dependence as a phenomenon of market failure, all of this amounts to claiming an efficiency principle in economic evolution, which is specified through the coordinative function of the price system in market competition. The competitive pressure of the market process is accordingly said to exercise an efficiency-enhancing impact on the learning efforts of market actors (Pierson 2000b: 487–90). However, these arguments promote only a partial view of the market process, as the selective efficiency of competition has been questioned repeatedly in the debates of evolutionary economics (Nelson 2002).

Because of the widespread misrepresentation of evolutionary reasoning in modern institutional economics, it may be useful to bring up some of its basic propositions. Above all, economic evolution is defined as the self-transformation of an economic system in historical time, caused by the internal generation of innovation and its local diffusion (Nelson 1995: 57–8; Witt 1993). Evolutionary models thus cope with the role of individual and collective learning as decisive factors in the knowledge-based interactions of market actors. The market process resembles an experimental discovery procedure that involves error and imperfection in the face of radical uncertainty (Dosi and Nelson 1994: 154–5). Crucially, the evolutionary perspective on economic change addresses organizational
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Coping with similar issues, the approach of organizational ecology perceives markets as evolving social systems. The diversity of organizational forms is derived from an understanding of market selection that involves cultural fitness and institutional legitimation (Hannan 2005). Thus, the interactive relation between organizational actors and institutional context becomes decisive for understanding the evolution of markets. Accordingly, evolutionary concepts of institutional change may go well together with a reconsideration of the social embeddedness of competitive interactions and governance structures (Gibbons 2005: 5; Guillén et al. 2002).

Clarified in a system theoretic jargon, then, markets may be characterized as diversified pluralities with a dominant structure that is accompanied by a variety of inter-penetrating components (Hodgson 1988: 167–8).

These considerations hint at the matter of governance, defined as an institutional mechanism that contributes to the maintenance of behavioural regularities and thus delineates the institutional terrain of markets (Crouch 2005: 20–1). This goes well together with Bourdieu’s view of markets as socially constructed fields of power relations that are generated by distinct social forces and mediated by the state (Bourdieu 2005: 12–13). Indeed, market transactions may be viewed as contested social processes that involve common rules and understandings. State, politics, and culture are inherent components in the institutional embeddedness of markets (Krippner et al. 2004). Accordingly, market actors support specific governance structures that stabilize the market process and regulate competition. Corresponding discourses on the legitimation of these control strategies contribute decisively to the evolution of markets (Fliess 2001: 12–16; White 1981). It follows that governance mechanisms exercise a major impact on the legitimation of organizational forms—and vice versa. Market regulation thus becomes an endogenous component of the market process (Dacin, Goodstein, and Scott 2002: 51–2). In consequence, the related operations of the state co-evolve with the market in a complex setting of institutional reproduction, adaptation, and innovation (Nelson 2002). Again, understanding the institutions of the market requires a move beyond its inherent boundaries.

0.5. A Guide to the Chapters of this Book

This book brings together the major lines of institutionalist reasoning on the institutional foundations of the market. It is meant to encourage cross-disciplinary dialogue, while allowing for a pluralism of conceptual
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Frameworks and methodological positions. Because of its concern with the institutions of the market, this book focuses on theoretical positions that are rooted in organization studies, institutional economics, economic sociology, and institutional political economy. The resulting exposition is divided into three parts, which are concerned with the organizational actors, competitive interactions, and governance mechanisms of markets. Part I presents explorations into the organizational behaviour of firms as market actors. It highlights issues of knowledge and learning in the formation of dynamic capabilities and organizational interactions. Part II addresses the institutional dynamism of market competition. In approaching markets as social systems, the social construction and structuration of competition is taken to the fore. Part III examines the subject of market governance. It accounts for the social embeddedness of market operations and thus approaches governance as an institutional process in the coordination of private and public sectors. Set out in more detail, then, the chapters of this book proceed as follows.

The chapters of Part I address the organizational behaviour of firms in the institutional setting of markets. Geoffrey M. Hodgson explores the intellectual history of the idea of organizational learning. In particular, George Henry Lewes's concept of the 'general mind' and Thorstein Veblen's notion of collective knowledge are taken to the fore. Both point out that the social store of custom and tradition is made up of accumulated knowledge. Learning is thus a process of positive feedback between individuals and society. Similar conceptions have become popular once again with the rise of modern behavioural and evolutionary economics, which account for organizational learning as a determinant of the market performance of firms. The latter line of reasoning is taken up in Sidney G. Winter's chapter on dynamic capabilities. These capabilities extend, modify, or create those learned patterns of behaviour by which organizations accomplish their productive tasks and maintain their profitability. However, in differentiating adaptive and proactive patterns of change, a decisive problem is posed by the question how apparent opposites, namely, novelty and familiarity, creativity and learned routine, come into a pragmatic synthesis. This question motivates the reconsideration of a 'hierarchy of change', which implies that higher-order dynamic capabilities such as capabilities for learning to change might exist. The specific interplay of rules and routines in organizational learning is discussed in Alfred Kieser's chapter. Rules and routines not only serve as organizational memories and repositories of knowledge but also determine the relation between stability and flexibility in the evolution of an organization. Distinct steps of rule-based organizational learning involve the experimental variation, selection, and retention of rules. Yet this process comes about only when actors successfully overcome learning barriers and thus complete the learning cycle. This is a precondition for an organization to succeed in correctly interpreting feedback information from its environment. Henrik R. Greve's chapter proceeds with the question how the institutional environment relates to organizational learning. Two areas of research on organizational change are distinguished: the concept of problemistic search and the concept of inter-organizational diffusion. Research on problemistic search examines conditions that give rise to organizational problems, whereas the theory of diffusion emphasizes the availability of effective solutions. Yet both perspectives rely on a similar model of managerial cognition and its operational effects. A theoretical synthesis thus may advance the understanding of how new behaviours are adopted by organizations. The chapter by Bob Hnings and Namrata Malhotra deals with the matter of change in institutional fields. It highlights the concept of institutional archetypes as a way of understanding radical organizational change within a field. The dynamics of change involve inter-organizational relations as well as the activities of individual organizations and groups within organizations. Organizational responses to institutional change need to involve aspects like values, interest, and power. The proposed process model of institutional change then addresses the de-institutionalization as well as the re-institutionalization of organizational components as an evolutionary process.

The chapters in Part II focus on the social construction and structuration of markets as social systems. The chapter by Neil Fligstein argues that market evolution is supported by a complex array of public and private institutions. This is illustrated by two cases: the emergence of the shareholder value conception of the firm and the rise of Silicon Valley as an innovative location for the computer industry. Countering the free market narrative, Fligstein suggests that both phenomena were embedded in pre-existing social relations framed by an interventionist government. Accordingly, in order to make sense of the direction of economic change, market structures need to be viewed in their larger institutional contexts. These concerns are shared by Rudolf Richter's survey of the literature on the social structure of markets. Arguing from the position of the new institutional economics, Richter deals with the claim that the social structure of markets matters for the performance of firms and
industries. Social structure is understood as a set of social relationships, which may be approached in terms of networks. Thus, markets can be understood as systems of network connections. What is in further need of clarification, however, is the role that actors and interests play in the formation of such a social system. The chapter by Peter Walgenbach and Renate Meyer maintains that organizational actors and interests need to be regarded as cultural constructions. In relating strategic action with the process of institutional innovation, a synthesis of organizational institutionalism and Giddens's structuration theory is at hand. This allows for a reconsideration of social practices through which organizational actors reproduce certain structures. Accordingly, institutional innovation is perceived as a representation of the structuring of organizations and markets through entrepreneurial efforts. A further elaboration on these concerns is given in Niko's chapter on organizational ecology as a theory of competition. Organizational ecology views market evolution as the development of populations of organizations that share formal rules and patterns of conduct in a similar market segment. Sociological aspects of that perspective are related to the classic works of Emile Durkheim and Amos Hawley. They actually inform those components of organizational ecology which address competition most explicitly, namely, density dependence and resource partitioning, accompanied by the spatial dimension of competition. An application of these concepts of organizational ecology to the comparative analysis of industry evolution is provided in the chapter by Filippo Carlo Wezel, Christophe Boone, and Arjen van Witteloostuijn. They derive variations of industry evolution from the timing of entry and development of national populations within the same industry. Cross-country density effects are interpreted as a result of international legitimation and competition spillovers. Thus, pioneer countries, defined as early entrants in the history of an international industry, function not only as broadcasters of legitimation but also as disseminators of competition.

In resuming the comparative perspective on economic evolution, the chapters of Part III examine the matter of market governance. Richard R. Nelson's chapter reviews the role of institutions in economic development. Nelson underscores that the process of institutional evolution is tightly intertwined with technological change. Accounting for that fact, the way productive activities are coordinated is denoted as 'social technology'. Institutions like legal rules and social norms support certain social technologies and make others infeasible. Yet the evolution of social technologies and their supporting institutions proceeds erratically. Ideological influences and a lack of reliable performance feedback imply that societies have very limited ability to design effective institutions. In accordance with these considerations, the chapter by Alexander Ebner addresses the co-evolutionary relationship between markets and states. This relationship is perceived as a key factor in the variety of governance structures that characterize complex market systems. In exploring that topic, the chapter surveys major contributions to the governance approach that have been emerging from the new institutional economics, including the work of Oliver Williamson, Douglass North, and Mancur Olson. Their critical assessment informs the conclusion that institutionalist theorizing requires an evolutionary conceptualization of institutional innovation as a driving force in the transformation of governance structures. The chapter by John Harriss then highlights the role of politics, power, and culture in the explanation of institutional change. The rational choice framework of the new institutional economics is criticized for its apparent limitations in theorizing on these issues. Therefore, Harriss underlines the analytical advantages of historical institutionalism. The conflict among social classes and the institutional substance of power structures are of particular analytical significance. They are interrelated factors in the evolution of cultural values, as exemplified by the case of Indian economic development and its sociopolitical underpinnings. Bob Jessop reconsiders these issues from a Polanyian perspective. Jessop's chapter interprets Karl Polanyi's institutionalist analysis of the market system in the light of two institutionalist schools, namely, the regulation approach to contemporary capitalism and systems theory with its account of the market as an autopoietic system. Both maintain that the market economy is an operationally autonomous system which is socially embedded and thus requires complex forms of governance. This is particularly relevant when it comes to governance in the knowledge-based economy. Robert Boyer's chapter examines the relationship between regulation theory and Bourdieu's sociology. Regulationist research has turned to Bourdieu's concepts of habitus and fields as a micro-perspective on macroeconomic phenomena. Habitus accounts for the evolution of preferences under contextual influences. The latter are shaped by institutional fields such as markets and industries, which are subject to complex forces of change, involving the reconfiguration of power relations. A significant proportion of theories in the new institutionalism has adopted these arguments. However, they are particularly well represented in economic sociology.
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