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Comment on Paola Palminiello/1. Calibrating the Utility of Rational Choice Institutionalism

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Comment on Paola Palminiello/1

Calibrating the Utility of Rational Choice Institutionalism

by Daniel Little

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Almost all human interactions fall within the scope of institutions, norms, and practices. These social arrangements set limits on individual conduct and define paradigms for collective action. Anyone who takes an actor-centered approach to the social world understands that these kinds of supra-individual limitations on action must be understood in terms of the interests and actions of the individuals who are involved in them [Little 2014]. Institutions require micro-foundations.

An actor-centered theory of institutions requires a substantial amount of bootstrapping: we need to have an account of how a set of rules and practices could have emerged from the purposive but often conflictual activities of individuals, and we need a similar account of how those rules are stabilized and enforced by individuals who have no inherent interest in the stability of the rules within which they act. Further, we need to take account of well-known conflicts between private and public benefits, short-term and long-term benefits, and intended and unintended benefits. Rational-choice theorists since Mancur Olson in *The Logic of Collective Action: Public Goods and the Theory of Groups* [1965] have made it clear that we cannot explain social outcomes on the basis of the collective benefits that they provide; rather, we need to show how those arrangements result from relatively myopic, relatively self-interested actors with bounded ability to foresee consequences.¹

¹ Peter Hall and Rosemary Taylor [1996] provide a nice overview of several different current approaches to the study of institutions: historical institutionalism, rational choice institutionalism,

Paola Palminiello [2016] is interested in shedding light on the questions of origins and reproduction of these kinds of social arrangements. Like other institutionalists, she wants to know how various sets of rules that regulate human behaviour emerge; and she wants to know what factors lend stability to a set of rules once it is in place. She offers a critique of existing theories, and she advances her own alternative.

Begin with the critique. Palminiello organizes much of her analysis around what I regard as a false assumption: that rational choice theorists have almost always violated their own strictures of methodological individualism by importing a social functionalism into their arguments. She writes:

In so doing, they also call upon the additional and definitely stronger idea that institutions exist precisely because they guarantee gains in terms of social welfare in a number of different ways [*Ibidem*, 4].

Palminiello characterizes this functionalism as a persistent tendency to assume that a set of rules persists because of its positive or efficiency-enhancing characteristics for society as a whole. She is right in maintaining that this functionalism is wholly unjustified (as Jon Elster demonstrated convincingly in many places [1983, 1985, 1990]). However, she is not right in thinking that rational-choice theorists usually make this mistake. Mainstream rational-choice institutionalists from James Coleman [1990] to Ken Shepsle [2006] to Sam Popkin [1979, 1980] to Jack Knight [1992] fully accept the idea that both emergence and reproduction of institutions (and other rules and practices) depend upon the interests and incentives that affect the individuals who participate in those institutions. It would seem that Palminiello is misled by the particular assumptions made by the researchers who have been prominent in attempting to explain the emergence of the institutions of European cooperation [especially Giavazzi and Pagano 1988]. It is possible that this group makes this mistake; but the broader tradition does not do so.

Here are a few representative statements from rational-choice institutionalists that bear out the observation that they are generally very aware of the need for individual-level explanations:

Much sociological theory takes social norms as given and proceeds to examine individual behavior or the behavior of social systems when norms exist. Yet to do this without raising at some point the question of why and how norms come into existence is to forsake the more important in order to address the less important. ... Social norms enter the theory developed here in the following way: They specify what actions are regarded by a set of persons as proper or correct, or improper or

and sociological institutionalism. Ostrom [1991] provides an extensive review of several prominent versions of rational choice institutionalism.

incorrect. They are purposively generated, in that these persons who initiate or help maintain a norm see themselves as benefiting from its being observed or harmed by its being violated [Coleman 1990, 241-242].

In this view of institutions, there is nothing exogenous about the rules of the game, and certainly nothing magical. They do not compel observance, but rather reflect the willingness of (nearly) everyone to engage with one another according to particular patterns and procedures (nearly all the time). The institutional arrangements are, in this view, focal [Schelling 1960] and may induce coordination around them.... Institutions are simply equilibrium ways of doing things. If a decisive player wants to play according to different rules – like the kid who threatens to take his bat and ball home if the rules are not adjusted to his liking – then the rules are not in equilibrium and the “institution” is fragile [Shepsle 2006, 25].

Similar statements can be found in Popkin [1980], Bates [1981], and Knight [1992]. Also of interest is the actor-centered approach to organizations offered by French sociologists Michel Crozier and Erhard Friedberg [1980]. Their premise is that actors within organizations have substantially more agency and freedom than they are generally afforded by orthodox organization theory, and we can best understand the workings and evolution of the organization as (partially) the result of the strategic actions of the participants (instead of understanding the conduct of the participants as a function of the rules of the organization).

They look at institutions as solutions to collective action problems – tasks or performances that allow attainment of a goal that is of interest to a broad public – but for which there are no antecedent private incentives for cooperation. Organized solutions to collective problems – of which organizations are key examples – do not emerge spontaneously; instead,

they consist of nothing other than solutions, always specific, that relatively autonomous actors have created, invented, established, with their particular resources and capacities, to solve these challenges for collective action [Crozier and Friedberg 1980, 15].

And Crozier and Friedberg emphasize the inherent contingency of these particular solutions; there are always alternative solutions, neither better nor worse. This is a rational-choice analysis, though couched in sociological terms rather than economists' terms. Important in the current context, they never attempt to explain a particular organizational arrangement in terms of its overall efficiency or the positive contribution it makes to the larger system within which it functions. In each of these instances the theorist begins with the situation of the individuals who are involved in the establishment and maintenance of the institutions in question.

So the sweeping critique offered by Palminiello fails to hit a target; the research framework of rational-choice institutionalism does not generally make the functionalist error that Palminiello attributes to it.

Turn now to Palminiello's positive theory. Palminiello is primarily interested in offering a new theory of the emergence and maintenance of institutions. Palminiello believes that it is possible to provide more rigorous micro-foundations for institutions based on her version of bargaining theory. The fundamental idea is that institutions emerge as individually acceptable solutions to problems of coordination where the benefits of coordination will only be possible if there are recognized and effective rules of behavior. So the object of bargaining is the particular set of rules that will govern the behavior of all the participants. She proposes that this new theory can explain both the emergence of regulative practices among a set of rational actors and can account for the continuing stability of those practices. Various affected parties formulate organized ideas about how cooperation might occur in a way that is advantageous to all participants; they then make arguments to other parties to persuade them to accept their proposed models. This is what she calls a "bargaining" theory of institutional emergence and maintenance.

In order to lay out her theory Palminiello sets up the parameters of a particular and limited framework of potential cooperation among rational agents. These are circumstances where there are potential gains from cooperation for all participants, but the gains will only be possible if behavior is limited by an effective set of rules that are supported by all agents. Here is her description of the task she undertakes:

More precisely, supposing that coordination-type institutions exist as well, I define the type of institutions which I intend to explain as repeated (or set up to exist through time) cooperation schemes planned out by individuals (groups or parties) as the best means, given the specific situations of mutual dependence in which they find themselves, to reach some of their objectives, and adopted in mutual agreement with others involved in those dependences because they are convenient for them too [Palminiello 2016, 11].

By bargaining it will be meant either the set-up, and establishment, of a scheme of cooperation as the best way of fulfilling the common interests of the parties and, through such interests, their diverging goals, or, in the event that the proposed schemes are more than one, the choice of the scheme to be adopted [*Ibidem*, 13].

This statement is fairly clear; it restricts institutions to situations of universal benefit. These are situations of cooperation. This is the domain that David Lewis considers in *Convention* [1969] – games of pure cooperation and coordination. The example of the escalator [Palminiello 2016, 10-11] is a perfect illustration of a piece of social behavior that represents a coordination problem. This is a special and limited

range of social interactions, but of course there are institutions in circumstances of competition as well. Institutions in the face of pure cooperation problems are the easy cases. Palminiello's definition of scope excludes situations where there is a significant amount of conflict of interest among the parties – what theorists of social action call “situations of competition and cooperation.” And it excludes as well institutional arrangements that are the result of being created by an authoritative super-agent – the state, the corporation, or the military. In these situations the participants have much more limited ability to negotiate the rules, or to disregard them if they find them unpalatable. This limitation is an important one, since it implies that her approach will only apply to a limited range of social and political institutions. So the bargaining theory offered by Palminiello will necessarily fall short of a full theory of institutions even if it is successful in its own terms.

A further complication derives from the fact that many of the examples Palminiello offers are *not* situations of pure cooperation at all. Instead, they are typically mixed games of competition and cooperation. Consider the following examples offered by Palminiello:

a taxation system; a pension system; the set of economic and political institutions necessary to achieve an efficient society; the whole of economic and political institutions able to realize a social-democratic society; corruption relations such as tangentopoli; State or public solutions to the tragedy of commons (taxes and subsidies), market or private measures (assignation of property rights), or finally decentralized solutions (agreements between users) to this kind of problems; the organization of the euro zone; the system of crowd-funding as both a solution to the problem of scarce public resources and an alternative to the market; the informal regulations adopted by the first private radio stations; the creation of a local currency; a rationing system; a national wage agreement; a company salary agreement; an industrial district [*Ibidem*, 11].

These are not examples of institutions involving pure cooperation because most of them define sets of winners and losers. There are competitive interests in most of these situations that will come into play in the establishment of one set of rules or another. It is therefore unclear whether the bargaining approach that Palminiello offers would even apply to these instances. Moreover, most of these examples include situations where there are significant inequalities of resources and power among the affected parties; and these inequalities have historically implied that some parties may be worse off within the proposed institution than outside the institution. Pure bargaining may indeed suffice to explain the emergence of sets of rules that benefit all participants roughly equally; it will not suffice to explain the emergence of sets of rules that distribute costs and benefits very unequally and that have emerged

through the artful application of various forms of power on the part of one or more participants against the rest. This is the key insight of Jack Knight's rational-choice analysis of institutions [1992]. But the premises of the bargaining theory advanced by Palminiello are tailored to the pure cooperation cases – not these more complex examples of conflicting interests and inequalities of power. It is not apparent that the bargaining system based on unanimity that Palminiello describes could in principle explain the emergence of a system of taxation.

Core to this analysis is the idea that the parties need to formulate proposals that they think will work to capture the collective benefits desired, and then transparently and honestly make the case to the other parties that these are the best arrangements possible. This description explicitly excludes the use of deception or threat in advocacy for a preferred scheme of cooperation or set of rules. The case for strict honesty, however, is unconvincing. Why would self-interested individuals not sometimes have an interest in misrepresenting their beliefs about the future in order to gain assent in the present? Palminiello's response is that the proposed arrangement needs to work as advertised if assent is to persist, and this requires a truthful description; but this seems unconvincing. A pirate captain recruiting a crew may base his or her recruitment plan on the idea of joint efforts, joint risk, and joint equal rewards. But he or she may have an interest in over-stating the amount of booty likely to be captured in the upcoming voyage; in dissembling about the likelihood of a fat merchant ship behind the next island; and in diverting some of the booty before dividing it. The rank-and-file pirates have been persuaded to contribute their labor on false pretenses. The adage, "no honor among thieves," supplemented by artful deception and manipulation, seems to work well for criminal enterprises. So the assertions offered concerning "formation of beliefs" [Palminiello 2016, 14] as being fundamentally constrained by the requirement of honesty seem to be unfounded and unconvincing. Perhaps honesty is the best policy in the long run; but the typical pirate captain makes plans over the short- and medium-term. And for success in these frames, it is enough to gain assent on the basis of convenient exaggeration and falsehood. The same objections apply to the view of the compulsory role of sincerity in bargaining:

Statements in favour of the effective functioning of one's own scheme are clearly always sincere [*Ibidem*, 17].

Here again it appears that Palminiello's position is distorted by the examples of greatest interest to her – the highly public and large-scale agreements associated with European financial regimes. But these circumstances are not typical of more mundane opportunities for cooperation and institutions, because they are highly visible and subject to expert monitoring.

The premise that an actor-centered approach is needed if we are to understand the emergence and maintenance of institutions is certainly correct. Rational choice theory is one particular and specialized version of actor-centered social science. It differs from other approaches in the very narrow assumptions it makes about the actor's particular form of agency; it assumes narrow economic rationality rather than a broader conception of agency or practical rationality. What seems clear is that we need to take an actor-centered approach if we want to understand institutions – either their emergence or their continuing functioning and change. So the approach taken by rational-choice theorists is ontologically correct. If rational choice theory fails to provide an adequate analysis of institutions, it is because the underlying theory of agency is fundamentally unrealistic about human actors. Paola Palminiello is to be thanked for bringing focus to the importance of the conditions under which independent actors create and support institutions. Here I hope to have furthered the discussion by raising a few topics that seem to require further analysis.

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Comment on Paola Palminiello/1

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Abstract: This article responds to Paola Palminiello's provocative and valuable essay in this issue. Three central points are made. First, rational choice theorists have not generally violated the strictures of methodological individualism in their treatments of institutions. Second, the bargaining theory advanced here as a theory of the emergence and reproduction of institutions is limited in that it applies only to circumstances of pure cooperation. The theory does not give attention to situations of potential cooperation involving conflicts of interest among parties, and it does not address situations involving substantial inequalities of power among parties. Finally, Palminiello's argument that bargaining in the circumstances she singles out necessarily involves truthfulness on all sides is unproven.

Keywords: Institutions; Institutionalism; Rational Choice Theory; Collective Action; Microfoundations; Cooperation; Bargaining.

Daniel Little is a philosopher who has written broadly on the foundations of the social sciences, the philosophy of history, and global justice. His current book is *New Directions in the Philosophy of Social Science* [Rowman & Littlefield, 2016], and other recent books include *New Contributions to the Philosophy of History* [Springer, 2010] and *The Paradox of Wealth and Poverty: Mapping the Ethical Dilemmas of Global Development* [Westview, 2003]. He received his Ph.D. in philosophy from Harvard University. Since 2000 he has served as chancellor and professor of philosophy at the University of Michigan-Dearborn. His academic blog can be found at www.understandingsociety.blogspot.com.