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Preliminary draft, do not quote! Comments in English or French welcome!

Introduction:

In economics, political science and sociology a quite lively cross- and interdisciplinary debate about different kinds of institutionalisms and their respective merits in explaining institutional change is taking place (compare: Campbell 2004, Dequech 2002, Hall/Taylor 1998, Hodgson 2000, Nielsen 2001 and Rutherford 1995.). This discussion is oriented toward the main arenas of institutional change which are market processes, public discourse and processes of political influence or regulation.

A typical modern example for institutional change is the conflict between Shell Corporation and Greenpeace about the disposal of the oil platform Brent Spar. This battle between an NGO and a company is not an exceptional case. In one of the latest issues of the *Economist* we read about Coca Cola defending itself against green critics who take issue with the soft drink producer's water usage (*Economist* 8th Oct. 2005: 68/69) and a few months ago the same weekly newspaper published an especially featured article by McKinsey and Company's worldwide managing director Ian Davis who urged companies to build social issues into their strategy and to regain dominance in the debate about their role in society (Davis 2005).

The conflict over Brent Spar lead to quite a few institutional changes within Shell and also how democracies deal with conflicts around environmental issues. It seems that neither the "invisible hand" nor the firm grip of "Leviathan" or the "iron cage" can explain the evolutionary process that lead to the resolution of the conflict and the institutional change that was induced by it.

The aforementioned social sciences and their methodologically particular branches of institutionalisms which try to explain these mechanisms of institutional change, work on the basis of at least two distinct human actor models and, more general, philosophical foundations. One approach is built on phenomenological and pragmatist conceptions and the other is founded on rational choice assumptions.

Micro-Foundation of Institutional Explanations

In economics, original institutionalism started on the basis of a severe critique of the model of the rational utility maximizing actor in neoclassical economics (Veblen 1898) which therefore, according to institutionalists following Veblen's legacy, is to be abandoned in favour of a human actor model that places economic behaviour in its cultural context. However, Malcolm Rutherford, coming from this Veblenian tradition, interprets the work of Nobel laureate Douglass North as: "... attempting to bridge the gap between the traditional neoclassical view of mankind as a rational chooser and the old institutionalist perspective of mankind as a cultural product" (Rutherford 1995: 446/447). Nevertheless, according to Rutherford and others (Hodgson 2000 and Dequech 2002) North does not quite succeed in overcoming all problems involved in integrating these contradictory behavioural conceptions. Rutherford points out that: "Perhaps the most important of these problems relates to the reconciliation of the rational and the rule-guided aspects of human behaviour and to the development of a theory of ideology and ideological change. These problems will not be easily solved. To incorporate ideology will require much more extensive modifications to the neoclassical model than North has contemplated to date" (Rutherford, 1995: 450). Hodgson, therefore, emphasizes the human actor model as still the most clearly dividing theoretical element between new and old institutional economics: "Institutionalism is distinguished from both mainstream economics and the "new institutional economics" precisely for the reason that it does not assume a given individual, with given purposes or preference functions. Instead of a bedrock of given individuals presumed by the mainstream and new institutional economics, the old institutionalism holds to the idea of interactive and partially durable and self-reinforcing institutions" (Hodgson 2000: 325, compare also Fullbrook 2002).

However, a wider perspective which includes the current debate under the heading of new institutionalism in sociology (Brinton and Nee 1998 and DiMaggio and Powell 1991) and new economic sociology (Granovetter 1985, Smelser and Swedberg 1994) as well as political science (Campbell 2004) cannot help, but notice that the boundaries between pure rational choice approaches and notions of social construction, embeddedness and intersubjectivity become blurred and contested. Klaus Nielsen who attempts to provide an overview over these attempts of theoretical crossovers concludes: "In economics, sociology, and political science, the various examples of rational-action

neoinstitutionalism have begun to integrate the role of ideas and different perceptions of a given reality; social-constructivist neoinstitutionalism in all three disciplines has become more aware of the role of interests and power and perceptions of institutions as not only “taken for granted” constraints but also as products of purposeful human behavior; and, finally, mediated-conflict neoinstitutionalism in its various forms has begun to put more emphasis on interpretation and the role of institutions as scripts and templates” (Nielsen 2001: 509). However, Nielsen who lists and compares six different types of institutionalism in the social sciences and suggests potentially fruitful mergers, collaboration and joint work between them, does not provide more than a rather broad account of their similar basic assumptions on the one hand and their “deep-seated methodological differences” (Nielsen 2001: 513) on the other hand. Are scholars dealing with institutional change left with mere “golf clubbing”¹, i. e. an open pluralism of choosing whichever theory seems fit? Or does the theoretical debate so far allow us to derive a set of guidelines which assists researchers in understanding the strengths and weaknesses of particular approaches?

From the perspective of a political scientist and expert in empirical cross-country comparisons, John Campbell distinguishes three types of institutional analysis, namely: Rational Choice, Organizational and Historical Institutionalism (Campbell 2004: 11). His aim is to encourage a “synthetic move” (Campbell 2004: 29) which “... seeks to establish a more constructive dialogue among these paradigms that may result in building bridges and reconciling some of the intellectual disagreements among them” (Campbell 2004: 173). However, at the same time Campbell is aware of the distinct differences between the three institutionalist paradigms and that therefore an all-encompassing unified view is likely to be impossible. He highlights one of these differences in particular: “For instance, some institutionalists have fundamental disagreements over the micro-foundations of social action” (Campbell 2004: 29). He points out that: “Some rational choice institutionalists assume that people are motivated strictly by individual, material self-interest and that institution building results from the pursuit of these interests” (Campbell 2004: 29). And continues: “ In contrast, many organizational institutionalists assume that people are motivated by collective identities and cultural frames and that these drive institution building in ways that do not fit neatly with explanations based simply on the pursuit of rational self-interest” (Campbell 2004: 29). How irreconcilable are these theoretical points of view? What does it take to overcome or at least use such disagreements fruitfully to advance our understanding of institutional change? Campbell suggests that it “... is possible – even likely – that actors operate according to several logics of action, depending on the institutional and social circumstances in which they find themselves” (2004: 88). In his discussion of diverse institutional micro-foundations he quotes the work of Jack Knight as an open-minded or weak version of methodological individualism (2004: 88). On the other end of the spectrum of logic of actions are economic sociologists (i.e. organizational institutionalists in Campbell’s terminology) who favour a notion of social embeddedness or constructivism which is based on a micro-foundation of cognitive psychology or symbolic interactionism (Campbell 2004: 89).

In the following, I will try to evaluate the scientific debate around the philosophical and behavioural foundation of institutional change in democracies and market economies along the core questions of whether and how an integration of social constructivist (pragmatist) and rational choice conceptions is possible and fruitful. In the current debate about micro-foundations of explanations of institutional change I see three different particularly pronounced positions:

1. Pragmatists who tend to see these two approaches as fundamentally alternative ways of thinking (compare: Beckert 2003, England 1993, Joas 2000, 1997, 1992, Nelson 2003 and Veblen 1919). I will focus on Beckert’s works who argues that: “Over the last fifteen years, the notion of embeddedness has served as the crucial counter-concept used by economic sociologists to mark a distinctive approach to the understanding of economic processes (Granovetter 1985; Zukin and DiMaggio 1990). *Embeddedness* refers to the social, cultural, political, and cognitive structuration of decisions in economic contexts. It points to the indissoluble connection of the actor with his or her social surroundings” (Beckert 2003: 769).
2. Some authors who start from a rational choice platform suggest a potential integration of the pragmatist approach within a broadly defined rational choice framework (North 1993, 1998, Knight, 2001, 2001a and Knight/Johnson 1999). In Knight’s approach institutions are a by-product of conflicts over distributional gains. The outcome of these bargaining processes depends on the asymmetry of resource ownership, but is also influenced by ideology.
3. Other scholars who depart from a rational choice foundation argue that because pure rational choice is too narrow, it can and should be enriched or widened to include a fuller account of human

¹ This term was brought to my attention in a conversation with my colleague Graham Brownlow at AUT.

freedom and motivation to achieve favourable institutional change (Davis 2003, Elster 1998, Folbre 2001, Sen 1992, 2000, 2000a, 2002). This third thesis might be interpreted as leaning toward some kind of cross fertilization or combination of rational choice and pragmatist modes of explanation.

The evaluation will focus on the problem of how cooperation among actors with potentially conflicting interests can be explained. Though there are other areas of debate like uncertainty and innovation which are equally suitable for the purpose of this paper as highlighted by Beckert (2002: 3), I chose to concentrate on the issue of cooperation because it is not only central to explain institutional change, but also because cooperation is of equal importance in the works of all the three main representatives of particular scholarly views to be discussed in this paper (i.e. Beckert, Knight, Sen and Davis).

The often quoted metaphor of the Prisoner's Dilemma will be used in part 1 to set the stage and illustrate the problem under discussion. The following parts will discuss how Beckert (2), Knight (3) and Sen (4) interpret the dilemma. According to their particular interpretation all of these scholars develop a different stance toward the rational choice assumptions underlying game theory (i.e. the Prisoner's Dilemma) and hence, arrive at different conclusions for action theory to explain cooperative behaviour in real world situations.

1. The Prisoner's Dilemma

The name of the game comes from a particular illustration of a situation where two potentially self-interested people have to choose whether they will cooperate or not. It was created by Albert Tucker in the 1950s. The story behind it is that two criminals are arrested by the police for robbery and placed in separate cells. They both can either confess to the crime or not. The consequences in terms of years in prison are presented to them in the form of the following pay-off matrix (based on Hargreaves Heap and Varoufakis 1995: 146).

Prisoner's Dilemma matrix:

	Non-Coop Confess	Cooperate Not Confess
Non-Coop Confess	-5,-5	0,-10
Cooperate Not Confess	-10,0	-2,-2

The numbers in the matrix are negative pay-offs (years in prison). If both confess this is a watertight proof of their guilt resulting in 5 years in prison. This is the preferred (optimal) outcome because otherwise the judgement would have to rely on weaker evidence. As a consequence, a much lower sentence of 2 year each is likely if they both "do not confess". If only one confesses he will be treated as the "crown witness" and his sentence will be suspended because he helped to make the prosecution case. The other will have to bear an exemplary punishment (10 years) for being stubborn, showing no regret and wasting court time.

The abstract structure of all Prisoner's Dilemma situations no matter what the specific story behind it is looks like this:

Prisoner's Dilemma matrix abstract pay-off structure

	Non-Coop	Cooperate
Non-Coop	P,P	T,N
Cooperate	N,T	R,R

Key:

R = reward for co-operation, N = payoff for being naïve, T = temptation to defect, P = penalty for mutual defection.

$N < P < R < T$

Where

$N < P$ means that for the row player it is better to defect if the column player defects

$P < R$ means that for mutual defection the payoff is less than for mutual co-operation

$R < T$ means that if the other player co-operates, then it is better to defect (temptation!)

The standard assumptions of rational choice underlying game theory plus the usually assumed mutual common knowledge of all participants which leads to the conclusion that everyone will act according to those underlying behavioural rules leads both criminals to the Nash equilibrium of 5 years each. It is rational for both criminals to try to avoid the sucker's pay-off and to be tempted by the crown witness rule, so they will choose to confess. From the perspective of the criminals, this is a sub-optimal solution, however, unavoidable given the specific set of assumptions² including the mutual expectations concerning the behaviour of the other.

The popularity of the Prisoner's Dilemma as a metaphor for problems related to cooperation between two rational maximizing self-interested individuals is due to its resemblance with other theoretical terms in economics like "free rider", "principal agent" and "moral hazard" which all grapple with public good's related problems (Beckert 2002: 19).

2. Processes of mutual constitution explain cooperative outcomes

Contrary to game-theoretic prediction, we know from experimental evidence (Dawes et al. 1990, and Bohnet and Frey 1994 and Frey and Bohnet 1995 and 1997) and our own daily experience that empirically people in situations resembling the Prisoner's Dilemma do quite often choose to cooperate. Moreover, they do cooperate with mutual beneficial outcomes. However, Beckert does not want to criticise the rational choice model of behaviour on empirical grounds. On the contrary, it is his aim to show that it is normatively inappropriate and that there is a better theoretical and prescriptive alternative. Beckert writes: "The criticism of orthodox economic theory presented in this chapter does not proceed from the empirically observed discrepancy between theoretically deduced prescriptions of action and factually observed decision-making. ... The strength of the economic theory resides in the *normative* postulation of the connection between the action model of *homo oeconomicus* and a model

² Hargreaves Heap and Varoufakis find a Prisoner's Dilemma in Puccini's opera Tosca: „... there is a police chief called Scarpia who lusts after Tosca. He has an opportunity to pursue this lust because Tosca's lover is arrested and condemned to death. This enables Scarpia to offer to fake the execution of Tosca's lover if she will agree to submit to his advances. Tosca agrees and Scarpia orders blanks to be substituted for the bullets of the firing squad. However, as they embrace, Tosca stabs and kills Scarpia. Unfortunately, Scarpia has also defected on the arrangement as the bullets were real. Thus, an elated Tosca, expecting to find her lover and make good their escape, actually discovers that he has been executed; and in one of opera's classic tragic conclusions, she leaps to her death“ (Hargreaves Heap and Varoufakis 1995: 147).

of order derived from it in which efficient allocation equilibria prevail. Normative here means that recommendations for action can be derived from the theoretical models that imply how actors have to act if they want to optimize their individual utility, while the invisible hand of the market at the same time produces an equilibrium with optimal allocation of resources” (Beckert 2002: 8/9).

From the discussion of the one shot Prisoner’s Dilemma above, Beckert concludes: “that cooperation cannot be explained comprehensively as the pursuit of a self-interested strategy of maximization” (2002: 10). The question is: How can rational actors cooperate when non-cooperation is the dominant strategy?

There are generally two proposed ways of how to overcome the just described dilemma. One is the internal solution which does not require any changes in the game. The preferences and attitudes of the participants as well as the pay-off structure remain the same. The second is the external solution which adds new features to the game that is, some changes in preferences and beliefs of the participants or in the pay-off structure occur.

Internal Solution

Some game theorists have argued (Axelrod 1984, Beckert 2002: 23 and Hargreaves Heap and Varoufakis 1995: 167 pp.) that repeatedly played games (so called “supergames”) can lead to cooperation as a dominant strategy. However, this does only make sense if these games are repeated infinitely or if the number of rounds played is unknown resulting in a high probability of continuation for participants. Otherwise, the logic of backward induction leads to the dominance of the non-cooperative strategy as well (Beckert 2002: 24 and Hargreaves Heap and Varoufakis 1995: 168/169).

Even so, Beckert argues that the famous meta-strategy *tit-for-tat* does only assure dominance of cooperation on the basis of further specifying assumptions. Axelrod concedes: “An individual must not be able to get away with defecting without the other individuals being able to retaliate effectively. The response requires that the defecting individual not be lost in a sea of anonymous others” (1984: 100). Beckert emphasises this condition: “This point is very important because it refers to the significance of social structures as a presumption for the solution of the cooperation problem through repeated games” (2002: 26). Such a social structure by the way is implicit in Axelrod’s example of the US senate (Axelrod 1984: 16). For retaliation to work or for allowing actors to build a certain reputation, in principle, the smaller the group size the better. In addition, factors like transparency, the length of the relationship and the possibility of communication will influence the likelihood of an achieved dominance of the cooperative equilibrium (compare Olson 1965 and Olson 2000). Hence, “... supergames cannot be considered a complete solution of the cooperation problem” (Beckert 2002: 28). Moreover, even if we ignore all these factors, Beckert points out that whether players decide to cooperate depends on their individual level of discounting future expected gains of cooperation. “The higher the discounting, the lower the value of the expected future cooperation and the more likely noncooperation. Hence, the choice of strategy can be described as a function of the discounting parameters, which results, however, in the possibility of multiple equilibria, not all of which fulfill the condition of Pareto optimality and thus lead to the indeterminacy of the model” (Beckert 2002: 24). Hargreaves Heap and Varoufakis come to the same conclusion in their evaluation of the theory of repeated games and reputation: “... the difficulty with explaining prior beliefs which agents hold when these beliefs affect the character of the equilibrium and the difficulty with explaining how agents select one Nash equilibrium when there are many” (1995: 194).

External Solution

The oldest and probably best known external solution is Thomas Hobbes *Leviathan* that is the state or some other collective entity provides stable norms backed up by sanctions. Beckert characterizes the important ingredients of this solution as follows: “Norms and institutions that are to lead to overcoming the Pareto-inferior but stable equilibrium of the defecting strategy must therefore fulfill two conditions: first, they must first align the behavior normatively with cooperative behavior; second, they must be covered by sanctions that make observing the norm the superior, self-interested strategy of behavior” (2002: 29, compare also Hargreaves Heap and Varoufakis 1995: 148).

Returning to the story of robbery used to illustrate the Prisoner’s Dilemma, the Mafia would represent such a Leviathan solution. If both robbers belong to the organisation, the severe sanctions imposed by the Mafia for confessing and thus breaking their code of “honour” and the support provided while serving the prison term would ensure a stable cooperative equilibrium. Such a new situation would result in a changed pay-off matrix:

	Non-Coop Confess	Cooperate Not Confess
Non-Coop Confess	-5,-5 (-12,-12)	-1,-10 (-12,-6)
Cooperate Not Confess	-10,-1 (-6,-12)	-2,-2 (-1,-1)

However, what if the police create a witness protection programme to counter-act the Mafia meta-strategy which will again change the pay-off situation and make it attractive for both robbers to free-ride? Such a chain of changes in the pay-off structure is also possible for other types of social control. Thus, Beckert concludes: “Punishment itself can be supported by a metanorm but will then enter an infinite regression, which intensifies the free-rider problem in every round: who punishes the one who did not punish the renegade actor, who did not punish the renegade actor, and so on?” (2002: 31). Again, it is open whether and when a stable cooperative equilibrium will arise.

In addition, stabilizing norms can be explained by internal conviction. As Hargreaves Heap and Varoufakis point out, Kant who connects rationality with morality provides a ready reference: “His practical reason demands that we should undertake those actions which when generalised yield the best outcomes” (1995: 155). “But to what extent is such an understanding of norms compatible with the theory of rational action?” (Beckert 2002: 31). What is the source of this strong norm which overrules all immediate self-interested urges in a world of economic men?

A self-imposed cooperative meta-norm as suggested by James Coleman (Beckert 2002: 31) or Robert H. Frank (1988) based on a cost-utility calculation that compares the costs of internalization with the costs of sanctions is equally inconsistent with a rational choice framework. Both internal conviction and calculated internalization imply a change in preferences. “Such an argumentation is tautological. By assuming the change of preferences of the actors, it negates the prisoner’s dilemma as a starting problem” (Beckert 2002: 33).

Thus, Beckert firmly rejects all propositions to attain a stable cooperative equilibrium based on the rational choice model of behaviour. He concludes: “The critical consideration of the external solution of the cooperation paradox appealing to sanctions was to indicate that we cannot reduce social norms to economic acts of maximization but rather must grant them an autonomous status, which excludes the explanation of norms within the economic model of behavior. ... The internal solution presumes the high visibility of the actions of the actors as well as the expectations of long-term cooperative relations, which can be expected in relatively closed communities” (2002: 35). Similarly, these conditions have an autonomous status. They cannot be derived merely from repeated dealings among purely rational utility maximizing actors.

So what is the alternative explanatory framework that he proposes?

A pragmatic concept of intentionality and interaction

Before I try to sum up his alternative, it is important to point that Beckert “... does not call into question the at least intentional rationality of the actors as *homines oeconomici* ...” (Beckert 2002: 9). Instead he states: “Informed by the tradition of American pragmatism, I propose in this article to base the understanding of action in economic contexts on a “non-teleological interpretation of intentionality”, as elaborated by Hans Joas (1996). “The conceptualization focuses on the interpretative acts by which actors construct perceptions of rationality intersubjectively in the action process itself. Intentionally rational strategies are analyzed as constitutively anchored in the actor’s interpretation of the situation which he or she confronts” (Beckert, 2003: 770). Therefore he undertakes an elaborated effort to review sociological theory and to distinguish his approach from a sociological notion of norms (Durkheim, Luhmann and Parsons) which “... relies too much on the structuring effect of morality for social action” (2002: 260).

Note the two important elements which distinguish the pragmatist model of intentional strategic action from the one of rational choice: non-teleological and inter-subjectively interpretative. The goal focussed logic of rational choice theory relies on the clear separation of setting goals and pursuing them. Preferences are treated as given, subjective and stable. This implies an inactive phase of goal finding and calculation which precedes any activity or strategic move.

Pragmatists, however, assume that individuals do not need clearly defined goals to act³. They follow habits and routines and are ready to change and adjust any goals which come to their attention as inappropriate continually in the course of action. As John Dewey put it: “The idea of a thing intrinsically wholly inert in the sense of absolutely passive is expelled from physics and has taken refuge in the psychology of current economics. In truth man acts anyway, he can’t help acting. In every fundamental sense it is false that a man requires a motive to make him do something. To a healthy man inaction is the greatest of woes. Any one who observes children knows that while periods of rest are natural, laziness is an acquired vice – or virtue. While man is awake he will do something, if only to build castles in the air” (Dewey, 1922: 118 and 119).

The second element of *inter-subjective interpretation* is defined by Beckert as follows: “Interpretation is a social process in the sense that judgements on the relevant parameters of the situation are based on generalized expectancies which are, at least in part, intersubjectively shared” (2003: 773)⁴. This is based on George Herbert Mead’s concept of the self which is founded on symbolically mediated communication with others and the ability of an actor to take the role of the other and to form expectations about his or her attitudes. Mead points out that a certain degree of empathy or role taking is necessary to engage successfully in economic exchanges. It allows producers to offer objects that might be of some value to consumers (Mead, 1995[1934]). Thus, empathy is of equal importance as self-interest for a successful businesswoman or man.

Beckert combines this pragmatist model of action with Anthony Giddens’s theory of structuration (2002: 260 pp.). In his explanation the contingency of cooperative relations as symbolized in the Prisoner’s dilemma is stabilized by trust which is constantly renewed in communicative processes. He explains the emergence of cooperative norms based on a common understanding reached by the actors. The pragmatist behavioural assumptions of the inclusion of goal definition, role taking and communication in the process of action can explain how a cooperative equilibrium is reached in Prisoner’s dilemma situations. This conclusion seems to be supported by experimental evidence (Dawes et al. 1990, and Bohnet and Frey 1994 and Frey and Bohnet 1995 and 1997).

From a pragmatist perspective it is rational to cooperate, even in a one shot Prisoner’s dilemma if habit, communication, empathy, role taking or some other notion of common understanding (trust) lead to an expectation of a similar response from the partner in the game⁵. Attempts of prediction and strategic recommendation based on this approach will have to depend on contextual knowledge and have to account for dynamic (circular) relations of variables, in other words, because of the behavioural assumptions of the model it is impossible or at least quite hard to distinguish between endogenous and exogenous variables and to deduct linear causal relationships⁶.

³ In some situations it might even be counterproductive to pursue goals willfully and actively. Instead, Joas describes to fall asleep, weep or laugh as examples of “passive intentionality” or “meaningful loss of intentionality” (Joas 1996 and Joas and Beckert 2002:3).

⁴ Compare a quite similar perspective expressed by Hargreaves Heap and Varoufakis: „To conclude this section, let us make the view inspired by Wittgenstein very concrete. The suggestion is that what is instrumentally rational is not well defined unless one appeals to the prevailing norms of behaviour. This may seem a little strange in the context of a prisoner’s dilemma where the demands of instrumental rationality seem plain for all to see: defect! But, in reply, those radically inspired by Wittgenstein would complain that the norms have already been at work in the definition of the matrix and its pay-offs because it is rare for any social setting to throw up unvarnished pay-offs. A social setting requires interpretation before the pay-offs can be assigned and norms are implicated in those interpretations“ (1995: 162).

⁵ „Hence, a pragmatist understanding of action in economic contexts can assume that actors act intentionally rational, without implying that strategies are rational in any objective sense. This affects the notion of rationality itself: What is conceived to be rational cannot be concluded independently from contingent interpretations of actors and these interpretations themselves become parameters of the situation. Rationality is also in the sense a social construction (Beckert 2003: 776).

⁶ This methodological consequence might explain why this philosophically superior and up to date behavioural model is not very popular among mainstream economists.

To explain how Greenpeace could build up its strength and win the conflict with the much better endowed petroleum company, the pragmatist ideas about intentionality and interaction are helpful. An account of the conflict solely built on rational choice reasoning would be at a loss.

3. Cooperation evolves in context specific bargaining processes

Remarkably, Jack Knight's rational choice attempt to develop a dynamic and practical relevant explanation of the emergence of cooperative solutions in social conflict and dilemma situations has a lot of resemblance with Jens Beckert's approach of mutual constitution. On closer inspection we will see that not much of the traditional rational choice ideas remain unaltered.

Knight distinguishes *naïve* and *sophisticated* evolutionary theories of institutional change. The *naïve* ones include classical sociological approaches (Parsons 1945 and Merton 1968) and quite a few modern economic ones (Axelrod 1984, Brennan and Buchanan 1985, Posner 1980 and Williamson 1975, 1985). For the naïve sociological variant Knight criticizes: "It fails to explain behavior inconsistent with the defined institutional roles, and it fails to provide a unique explanation in those situations in which a social actor is confronted by conflicting roles" (1992: 15). The economic approaches are characterized as follows: "The naïve variant assumes that social institutions produce efficient or socially optimal outcomes. The sophisticated variant allows for the possibility that suboptimal institutions may develop and persist, but it retains the conception of collective benefits and seeks to explain these inefficiencies in the context of failures or weaknesses within the community" (Knight 1992: 10).

His explanatory goal is to develop a dynamic account of institution building and change: "... social institutions are conceived of as a product of the efforts of some to constrain the actions of others with whom they interact. ... The main consequence of this analysis is that the ongoing development of social institutions is not best explained as a Pareto-superior response to collective goals or benefits but, rather, as a by-product of conflicts over distributional gains" (Knight 1992: 19). Under the influence of Douglass North, he acknowledges path dependency and change of preferences: "Criticism of the assumption of stable preferences, however, is widespread, frequent, and often appropriate. For static analysis, the assumption seems a reasonable oversimplification. At any particular time we can reasonably assume, for example, that my preferences are fixed. But for a dynamic analysis such as a theory of institutional change, the assumption of stability can be problematic" (Knight 1992: 18). However, one may ask whether the assumption of stable preferences is not indispensable for a rational choice approach. Beckert at least in his critique seems to believe this the case.

My impression is that Knight clings to the label *rational choice* because he seems to think, this is necessary if one wants to start from a model of actors who pursue some kind of strategic intentionality⁷. In his account, individuals simultaneously strive for individual benefits and collective ones that allow them to achieve these goals with minimal costs. That is, they try to obtain efficient institutions. To return to the metaphor of the Prisoner's Dilemma that means the two players try to maximize their individual pay-offs and construct cooperative norms at the same time to circumvent the suboptimal outcome. Both strategic goals are intertwined. This may lead to multiple possible equilibria. Analysts will have to explain how this is possible: "To do so they should elaborate a mechanism that either connects collective benefits to the actors' intentions or shows how collective benefits are produced despite the actor's intentions" (Knight 1992: 27). Such an explanation is necessarily context and situation specific. "Rather, the implication is that the provision of the collective benefits must be justified on empirical grounds, not assumed because of some theoretical construct such as market competition" (Knight, 1992: 212). Consequently, in later publications Knight applies his framework of analysis to quite a diverse array of areas related to rule and norm setting in institutions and distributional conflicts such as lobster fisheries (Acheson and Knight 2000), the advent of neo-liberalism (Knight 2001), the legal system (Epstein and Knight, 2004 and 2000), anthropology of marriage (Knight and Ensminger 1998 and Ensminger and Knight 1997) and social capital formation (Farrell and Knight 2003).

In their quest for distributional advantages economic and political actors bargaining will produce certain social institutions as a by-product. As Knight points out: "By this I mean that social actors produce social institutions in the process of seeking distributional advantage in the conflict over substantive benefits. In some cases they will create institutional rules consciously; in other cases the rules will emerge as unintended consequences of the pursuit of strategic advantage" (Knight 1998: 107 and 108). Knight views the asymmetry of resource ownership in a society as the main factor explaining the resolution of bargaining over social institutions. For the conflict over Brent Spar this would have

⁷ Note that Beckert does not think so.

lead to the prediction that Shell will win. However, Knight is aware of the influence of ideology, non-material preferences and change of preferences in these processes and concedes: “But asymmetries in power do not imply that those who cannot successfully assert their will have no influence. In cases of spontaneous emergence, the final institutional form is the by-product of repeated conflicts among actors with varying capacities” (Knight 1992: 211).

Three different types of rational choice

To highlight the advantage of his bargaining theory that explains the emergence of institutions in terms of asymmetries of power in society, Knight compares his approach to two others: a theory of the evolutionary emergence of social conventions and a market-based theory of exchange and selection through competition.

Two-Person Strategic Game:

	Player 2 X	Player 2 Y
Player 1 X	a1, a2	b1, b2
Player 1 Y	b1, b2	a1, a2

Source: Knight 2001a: 34

To illustrate the differences in these three theoretical rational choice variants Knight draws the matrix above, which has two players and two choices of action (X and Y). “The payoffs are characterized by the variables a and b . If $a_{1,2} > b_{1,2}$, then there are two Nash equilibria in the game, (X, X) and (Y, Y). The strategic problem for the players rests in the fact that without more information about the social context in which the interaction takes place, they do not know on which equilibrium to focus their strategic choice” (Knight 2001a: 33).

According to Knight some rational choice theorists (conventions approach) focus on $a > b$. Actors do not intentionally produce a rule that ensures a Pareto-superior equilibrium. However, it evolves unconsciously based on some arbitrary unexplained feature in the context because the players realize that $a_1 + a_2 > b_1 + b_2$ and thus will arrive and remain in the favourable equilibrium (Knight, 1998: 102 and 103).

The contract approach (based on markets and competition) does also concentrate on the relationship $a_1 + a_2 > b_1 + b_2$. Players will compare the costs of institutional arrangements that allow them to maximize $a_1 + a_2$. If the benefits from an institutional change exceed the costs they will welcome an institutional change. Competition among different institutional arrangements selects the least costly institutional form (Knight 1998: 106).

As described above, Knight’s bargaining approach does assume that both players gain differently depending on which institutional form is chosen. That is, $a_1 > a_2$ in one equilibrium and $a_1 < a_2$ in the other. Hence, depending on their bargaining power (resource endowment) players will struggle for a particular institutional outcome which will ensure a favourable distribution for them (Knight, 1998: 107).

Pragmatist elements

As we have seen above, Knight is quite aware that enforcement of social norms which ensures distributional advantages for the powerful is not necessarily straightforward (Knight and Ensminger 1998: 106). Ideological values and non-material preferences can have a considerable effect on the outcome of conflicts.

While Knight and Johnson criticize contemporary pragmatists for a neglect of power imbalances and consideration of feasibility of open democratic deliberation (Knight and Johnson 1998: 574), according to Knight pragmatists are not mistaken when they ask: “How do we diminish as far as is possible the

role of power in generating or sustaining social consensus?” (Knight 2001: 45). To achieve this, might be a formidable task, however, Knight agrees with pragmatists that: “The free and equal participation condition is fundamental to arguments about the beneficial role of institutional mechanisms in solving collective problems in society. Establishing the circumstances under which the condition is satisfied, is a necessary precondition for the effective operation of the relevant institution. To the extent to which this condition is not satisfied, the arguments in support of the superiority of a particular institutional mechanism are undermined” (Knight 2001: 41).

In the case of the conflict around the Brent Spar this condition of non-domination was seemingly not fulfilled. Nonetheless, it is open whether the public process lead to a superior knowledge base and better solutions to collective problems in the corporate world. Knight, however, endorses the open process attitude and combination of ideas and interests in explaining construction and change of institutions in pragmatism: “Each of the institutional types in the feasible set can be characterized as a mechanism for aggregating (1) individual interests and (2) individual ideas, beliefs, and knowledge. The aggregation process may involve various combinations of social interactions, including competition, deliberation, voting, and bargaining. The underlying justification for aggregating individual ideas and beliefs is that the aggregation process will produce a collective base of knowledge that is superior to that of any individual and, thus, the collective decision will be better than that of any individual participant” (Knight 2001: 35).

4. Capabilities and freedoms of the reflexive self

Nobel laureate Amartya Sen starts his review of the significance of the Prisoner’s Dilemma with a thorough review of the underlying assumptions about human behaviour in game theory: “But nevertheless it can be argued that the structure of formal game theory builds into it some limiting assumptions that restrict the class of “value systems” that can be admitted, and some broadening of that structure may now well be overdue” (Sen 1985: 207). This neglect of any other values is his focus in overcoming the suboptimal equilibrium outcome, and explaining why such a solution according to experimental evidence in fact happens (Sen 1985: 215)⁸.

Sen concentrates on game theory’s implicit rationality assumption of *goal-priority* which he defines as: “Each player pursues his or her goal subject to feasibility considerations, without being restrained by any other values” (Sen 1985: 208). He argues that it is odd to assume that people do not recognize the existence of other people’s goals, which is actually part of living in a community and that they should not be able to identify that all involved in the dilemma situation would win as a group if they restrain their pursuit of purely individual goals.

To see why and how narrow goal-priority can be overcome we have to acknowledge that actors are capable of a commitment with others and to certain values. To strengthen his argument, Sen distinguishes sympathy from commitment: “The former corresponds to the case in which the concern for others directly affects one’s own welfare. If the knowledge of torture of others makes you sick, it is a case of sympathy; if it does not make you feel personally worse off, but you think it is wrong and you are ready to do something to stop it, it is a case of commitment” (Sen 1978: 31).

According to Sen, such commitment disregarding our (positive or negative) feelings towards the other person is based on a sense of identity of a person that is, how the person sees himself or herself. Quite congruent with George Herbert Meads’s account of the formation of the self, however, without any reference to this pragmatist Sen argues individual identity is based on identifying with others or a group: “The nature of our language often underlines the forces of our wider identity. “We” demand things; “our” actions reflect “our” concerns; “we” protest at injustice done to “us” (Sen 1985: 215). According to Davis, this “we” language in social groups is tied to how we see ourselves as individual members of social groups (Davis 2003: 192). It leads to a collective intentionality which, however, is “reflexive or self-referent” (Davis 2003: 191).

Sen and Davis stress that identity and commitment allow for counterpreferential choice and disconnection of a person’s choice from the pursuit of self-goal: “The characteristic of commitment with which I am most concerned here is the fact that it drives a wedge between personal choice and personal welfare, and much of traditional economic theory relies on the identity of the two” (Sen 1978: 33). However, neither of them wants to argue that this will turn the actor into a “cultural puppet”: “The point is not that rationality must take us to the communal principle, rejecting the individualistic one,

⁸ That the strict pursuit of individual goals may even lead to an absurd outcome is illustrated by Sen in this little story: “‘Where is the railway station?’ he asks me. ‘There,’ I say, pointing at the post office, ‘and would you please post this letter for me on the way?’ ‘Yes,’ he says, determined to open the envelope and check whether it contains something valuable” (Sen 1978: 35).

but that there is a genuine ambiguity here about what rationality might require ...” (Sen 1985: 212). This distinction between individual utility maximization, well-being and agency is further developed by Sen in his capability approach.

Capabilities

Sen argues that agency and well-being are not similar to maximizing utility. He states that well-being may even have nothing to do with momentary happiness or fulfilment of desires: “‘Being happy’ is not even a valuational activity and ‘desiring’ is at best a consequence of valuation. The need for valuation in assessing well-being demands a more direct recognition” (Sen 1992: 46). Cases are imaginable where individuals might value certain acts and their freedom to act very high, though these might have no positive effect upon their well-being or even a negative one: “Indeed, the person himself or herself may have reasons for pursuing goals *other than* personal well-being or individual self-interest” (Sen 1992: 55). Freedom to choose is a value in itself, despite of the utility resulting from an act: “If, for example, all the alternatives other than the one actually chosen, were to be eliminated, this need not affect achievement (since the chosen alternative can be still chosen), but the person clearly has less freedom, and this may be seen as a loss of some importance” (Sen 1992: 60). That is, if we are conditioned or channelled to become a highly capable, successful website designer, earning a high salary, and it could be determined that this would optimize our income and contribution for society, still something is lost, if we were not allowed to try out other aspects (capabilities) of our personality (e.g. did not have the chance to become a third rate rock musician, poet, janitor or whatever). Though in most cases well-being might be related to agency, sometimes positive well-being might occur without any causal link between the acts of a person and his or her well-being (e.g. a patient in a hospital or the child of a caring parent). Thus, freedom to act is not the only welfare criterion.

To defend ones capabilities or freedom to act, not only negative freedom (absence of external coercion and constraints of action) but also positive freedom (autonomy in the sense of absence of inner pressure) has to be guaranteed⁹. Only in case of given negative *and* positive freedom, agency might lead to self-fulfilment (cf. Sen 1992: 56/57).

Thus, Sen distinguishes freedom from well-being. In John Davis’s interpretation of Sen’s approach, this leads to four different combinations of individual advantage: “These two distinctions yield four sometimes overlapping, but relatively distinct, concepts of individual advantage for Sen (see Table 1). They are; (1) well-being achievement, (2) agency achievement, (3) well-being freedom, and (4) agency freedom The first represents the traditional concern of mainstream economics with individuals’ satisfying their own preferences. The second, concerns individuals’ ability to achieve goals that do not involve their own well-being. The third concerns individuals having the freedom to pursue their own well-being. The fourth concerns individuals simply having the freedom to pursue all their goals, whether or not they are successful in achieving them (Davis 2002: 487).

Table 1: Sen’s four concepts of individual advantage

	Well-being	Other goals
Freedom to achieve	Well-being achievement (e.g. old-age pensions)	Agency achievement (e.g. heroic sacrifices)
Freedom to pursue	Well-being freedom (e.g. occupational choice)	Agency freedom (e.g. fasting)

Source: Davis 2002: 487.

Davis concedes that such a multi-goal framework might be criticized for its insufficiency in determining social policy, however, its advantage is “... the flexibility it provides in being able to address the great variety of different types of valuation problems that social policy confronts” (Davis 2002: 487).

The approach of capability (agency) and well-being allows Sen and his colleague Martha Nussbaum to come up with a catalogue of core human functional capabilities (cf. Nussbaum 2000: 78-80), which are indispensable for human well-being and agency. This is the list of headings of those central capabilities: 1. life, 2. bodily health, 3. bodily integrity, 4. senses, imagination and thought, 5. emotions, 6. practical reason, 7. affiliation (A. social interaction and B. self-respect), 8. other species, 9. play, 10. control over one’s environment (A. political and B. material). Though such a catalogue lays the ground for interpersonal comparison of well-being, freedom and distributive justice, the concept

⁹ Compare Charles Taylor’s arguments (1995: 121) which are based on the distinction made by his teacher Isaiah Berlin between negative and positive freedom (1970).

remains inevitably vague and demands for more detailed criteria that have to be discussed and agreed upon and might be cultural specific in its their concrete form (*Gestalt*) (cf. Nussbaum 2000).

5. Conclusions

Beckert regards the pragmatist approach as a distinct alternative to rational choice reasoning. Individual intentionality is based on intersubjective interpretation and cannot avoid it because goals are defined in the process of social deliberation. The pursuit of individual interests cannot be understood without drawing on intersubjective interpretation. Cooperation by individuals and the process of incremental change of institutions can hardly be separated from each other and have a foundation which is autonomous from individual interests. Because rational choice denies intersubjective interpretation (i.e. assumes stable preferences) and is riddled with multiple equilibria, it cannot explain cooperation.

Knight sees his concept as a dynamic variant of rational choice theory which is based on conflicts of interests and bargaining processes. He stresses that the construction and change of institutions is influenced by and linked to a struggle for particular interests. Thus, different institutional arrangements have different distributional outcomes and multiple equilibria are possible. However, he acknowledges the influence of ideologies and non-material preferences on the process of institutional change. This influence allows for preference change among the actors. He is aware of the advantage of pragmatism in explaining these influences and the resulting change in values as context specific and based on ongoing experimentation in collective learning processes.

Sen argues in favour of a notion of enriched and widened strategic and value based choices. His ideas on commitment and identity based on interaction with others are very similar to the pragmatist social value theory. However, he does not acknowledge any influence by pragmatist philosophy. Sen is keen to demonstrate that the conceptual changes to the rational choice approach are only incremental. Nevertheless, he asserts that they will probably lead to a considerably changed way of analysis. This is his capability approach.

	Beckert/Joas	Knight/North	Sen/Davis
Limits of rational choice	Cannot explain cooperation and neither origin, nor change of institutions.	Does not account for the role of ideology and preference change in processes of institutional origin and change.	Disregards the commitment to values and freedom of action which can override the pursuit of interests and well-being.
Role of Pragmatism	Pragmatism as alternative paradigm.	Pragmatism as supplementary to a dynamic variant of “rational choice”.	Rational choice extended and changed based on “pragmatist” ideas.

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