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The Distributional Impacts of Institutional Reforms

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Abstract

The aim here is two-fold. First, the author intends to show that the statement that the new institutionalists pay no attention to aspects of distribution can be refuted. To do that, he examines works by outstanding authors from this analytical tradition. In the second place, the article tackles the review and broadening of a very well-known, orthodox graphic toolkit to carry out a very persuasive systematic analysis of the main ways that institutional reform impacts distribution and influences the total volume of transaction costs for the participants in each institutional sphere. This analysis also makes it possible to underline that the rules that certain agents perceive as causes of the transaction costs they pay are viewed by others as the mechanisms that allow them to finally obtain better distributional results, at least in the short run, even if they have to pay the habitual transaction costs associated with any negotiation. Although these ideas are certainly foreign to the investigative process of many new institutionalists, this is not the case of others such as North, Eggertsson, Libecap, Ostrom, and even Williamson and Ménard. Obviously, this dimension of distribution is often of great concern for researchers who work in the framework of other currents of analysis, but the aim of this article is not to examine these other contributions, but to show that these aspects are gaining more and more ground in the framework of the new institutional economics.

Key words: distributional consequences, institutional reforms, new institutionalists, stylized graphic analysis, negotiation rights and capabilities.

JEL **Classification**: D02, D3, D7.

Introduction

The aim of this article is in the first place to show that aspects of distribution are also being taken into account by outstanding authors in the field of the new institutional economics. Several of them have even been president of the International Society for the New Institutional Economics (ISNIE). The second aim is to contribute, by reviewing and broadening a well-known, orthodox graphic

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instrument, to a very persuasive systematic analysis of the main ways that an institutional reform causes very important distributional impacts on the different participants in addition to affecting the total volume of transaction costs that these agents as a whole must cover.

To achieve these objectives, the text after this introduction is organized as follows: in the next section, I examine outstanding new institutionalists' work that pays attention to distributional issues to a greater or lesser extent. This is the case of some of the work by authors such as North, Ostrom, Greif, Knight, Eggertsson, Libecap, Winiecki, Horn, or Weingast. Then I will demonstrate the graphic toolkit to be used and the modification needed for it to be useful for the aims here; then, I will carry out the stylized graphic analysis of the distributional impacts of institutional reforms. This analysis will show how institutional reforms have a different influence on the rights of diverse kinds of participants and on their relative opportunities and capabilities for acting and negotiating. They do not only affect, then, the total amount of transaction costs paid by all these participants. These and other conclusions are summarized in the last section.

In order to avoid any wrong interpretation of the conclusions we can reach with this research, it is necessary to mention that I am not saying here that a majority of the authors who participate in the ISNIE congresses and consider themselves new institutionalists have broadened out their approach to include distributional issues. Although the approach has broadened considerably since the work published in the 1970s and 1980s, the work that explicitly mentions the distributional dimension continues to be in the minority. Therefore, putting to one side the ever-present specificities and differences in hypotheses, it is necessary to underline here that the majority analytical approach continues, undoubtedly, to be these authors' special concern with transaction costs and their effects on the greater or lesser efficiency in each institutional sphere researched, both in the private sector, markets, and companies, and in the public sector and political processes.

Despite all this, it is also possible to affirm that by the 1990s, clear dissatisfaction already existed among the new institutionalists with the kind of economic analysis being carried out using traditional neoclassical ideas, which had inspired their own pioneering contributions in the 1960s and 1970s in fields like the so-called theory of property rights.[1] Like with those contributions, they are

[1] About these contributions, see Eggertsson (1990: Ch. 8).

little related to the methodological approaches and normative positionings that usually predominate in the work of the *old* institutionalists.[2] In that sense, today, the majority is clearly made up of authors who work under the assumption that people have bounded rationality, not unlimited capabilities for processing information and making calculations.[3] That means that these analyses do not usually attribute agents with having perfect or complete information; they also do not put forward the idea that obtaining information is costly and that therefore, the agent will "optimize" the search for it. On the contrary what is usual is to find analyses based on the presumption that agents may act opportunistically, renege on their promises, reveal distorted information, and even break the law.

Williamson (2002a; 2002b) has summarized some of these main differences between the approach of the new institutional economics and what he himself has called the "neoclassical orthodoxy." He situates these differences in three essential aspects. The first and main one refers to the fact that while the institutional or transactional perspective makes it possible to emphasize features related to negotiation and the possible profits from the exchange that could result from it, among many other aspects, the traditional neoclassical approach leads to a focus on micro-economic problems from a perspective that seeks to determine the most efficient assignation of scarce resources (prices and the equilibrium of production are the fundamental concerns of those analysts). Secondly, and linked to the previous point, in traditional neo-classically-inspired analyses, companies are often conceptualized, according to Williamson, as if they were functions of production that should be maximized; while the transactional perspective makes it possible to emphasize issues related to the structure of government of those companies and the webs of formal rules and informal norms that constrict the interactions of participating agents. And, thirdly, says Williamson, the transactional perspective linked to analysis carried out in the framework of the new institutional economics facilitates our being able to

[2] Examples of works that examine those traditional differences in approach between the new and the old or pioneer institutionalist economics are Hodgson (1989; 1993; 1998); Rutherford (1994; 1995), Toboso (1995; 1997; 2001; 2013) or Hutchison (1984). Caballero and Kingston (2009) do a very extensive review of different contributions to the study of institutional change from the standpoint of different currents of institutional analysis.

[3] On the supposition of bounded rationality, see Langlois (1990), Williamson (1990), Selten (1990), Knudsen (1993), Kahnerman (1994), or Pagano (2007), in addition to Simon's classic works (1976; 1978; 1979).

incorporate into our understanding the contributions that have been made in other fields, such as organizational theory.[4]

So, depending on the area of research, it is an easy matter today to find works in which the new institutionalists pay attention, for example, to the degree of credibility of commitments, issues of governance, social norms and values, ideological convictions and predilections, support mechanisms, social capital, strategic behavior, bounded rationality, opportunism, adverse selection, moral hazard, contractual agreements, uncertainty, supervisory costs, incentives to collusion, or hierarchical structures.[5] Or, for that matter, as we will see in the next section, even conflicts involving distribution, the negotiating clout of one or another participant, asymmetrical information, or anyone's persuasive abilities.

It is not by chance that Elinor Ostrom, recently awarded the Nobel Prize for economics, explicitly mentions the need to go beyond theoretical panaceas to "to build a strong interdisciplinary science of complex, multilevel systems that will enable future diagnosticians to match governance arrangements to specific problems embedded in a social–ecological context, thus avoiding making simple, predictive models for deducting universal solutions, panaceas, to complex, situational collective problems."[6] Her analyses about the importance of social capital and other reputational and relational aspects as factors that can aid in solving or mitigating problems of collective action and social coordination are also well known.[7] It is not by chance either that North wrote:

> In contrast to standard (neoclassical) theory that draws its inspiration from physics, modeling the process of change must derive its inspiration from evolutionary biology. But in contrast to Darwinian theory, in which the selection mechanisms are not informed by beliefs about the eventual consequences, human evolution is guided by the perceptions of the players in which choices decisions are made […] in pursuit of their goals (2005b: 21).

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4 Also see Williamson (2000; 2003).

5 Also see the collections of works published in Ménard (2004), Ménard and Shirley (2005), Svendsen and Svendsen (2008), Toboso and Arias (2006), or the books by North (2005a), Eggertsson (2005), and Ostrom (2005).

6 Also see Ostrom (2007b).

Examples of analyses that pay attention to distributive aspects

Having made explicit these characteristics of the majority approach, it is now necessary to show some examples of analyses in which, in addition to the aforementioned amplifications, attention is also paid to distributive issues. As stated above, the ultimate aim of this article is to refute the affirmation that the new institutionalists continue ignoring these issues. To do that, it is not necessary to review all their contributions, but to examine only a few outstanding examples.

The first one to mention is Douglass North. Although North usually centers on analyzing matters involving the efficiency of one or another institutional framework, linking his diagnosis to the greater or lesser total transaction costs accruing accordingly to the participants, he has also published works containing explicit references to distributive aspects or participants' power of negotiation. These works are, then, the first example to be examined here. Thus, in his "Institutions and the Performance of Economies Over Time" (2005b: 112), he refers to the "violent struggle among competing groups for control of the polity and economy" that took place in all the new Latin American republics after the defeat of the Spaniards and the emergence of the independence movements. Even though many countries adopted one or another version adapted from the United States of North America Constitution after their independence, the consequences of those institutional frameworks, writes North, were radically different from what was expected, given all those countries' colonial heritage. Their economic and trading systems were basically oriented toward the extraction of precious metals for the Spanish Crown, which bestowed the exclusive monopoly of such activities on specific groups, also restricting trade to a small number of ports among all the existing ones in South America. The evident and well-documented aim of this institutional set-up, writes North, was to facilitate the extraction and shipment of precious metals to Spain, not to promote the development of the people living there.

According to North, since these countries did not have a tradition of democratic self-government, well-defined political and market rules guaranteed to be complied with, or a socially legitimate distribution of the ownership of economic resources, their independence ended by leading to a violent battle among different groups to capture the political process and control business. The groups that emerged victorious set up authoritarian regimes to ensure the order that benefitted them, and the phenomenon of the *caudillo*, or strong leader, became omnipresent. But new conflicts soon arose between those initially benefitted by the Crown and the new governing elites and their support system, who were not among that small number of land-owning families and members of the Church to whom the Crown had given enormous tracts of land and local production and trade monopolies. The result, according to North, was ongoing political instability and the quest for rent, with very negative effects on productive activities. The enormously unequal distribution of rent and wealth, the almost non-existent provision of public goods, and the extreme poverty that plagued a considerable part of the population of many of these countries are to a great extent the result of that institutional dynamic. North concludes that the explanations of underdevelopment rooted in the relative existence of physical capital or the formal configuration of institutions cannot ignore the relevance of informal institutions and the conflicts that can emerge in many instances.

Of course, all of North's arguments are debatable. However, they do reveal that some of his analyses delve into issues of distribution, conflicts of interests, and the existence of groups of people with different capabilities for influencing the new rules of the political and economic game that are created and amended, or with different capabilities for negotiating under the existing rules. In *Understanding the Process of Institutional Change* (2005a: 165), North also writes: "As noted above, alteration of the economic rules entails winners and losers and it is essential to be aware of them." In 1990, he had already explicitly written: "Institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules." Similarly, another former ISNIE president, Eggertsson, explicitly stated that the new institutional economics perspective "also provides an opportunity for explaining the institutional arrangements that affect the relative power of workers and employers, and exploring how these power relationships emerged and how they are maintained. […] The framework does not suggest that all institutional change is explicitly designed to increase aggregate wealth as many critics seem to believe. Purposive institutional change reflects both the power and interests of those who control institutional change and the process for making decisions in the political sphere."[8]

[7] See Ostrom (2005), Ostrom and Ahn (2008), Ostrom and Walker (2005), or Poteete, Janssen, and Ostrom (2010).

[8] See also Eggertsson (1995: 48) and Toboso and Compés (2003: 664).

Knight and North (1997) and Knight (1992) are two other classic examples. Many analysts' emphasis on the total benefits that a group of people obtain from existing institutional set-ups, say Knight and North, leads them to ignore a very important dimension of human interactions in any institutional setting. This is the dimension of distribution and the conflict of interests that can arise with regard to the existing institutional *status quo* in each sphere and its possible channels for reform. And this is the case both for formal and informal institutions. Knight writes:

> The main consequences 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. In order to avoid unnecessary confusion, let me underscore here that the claim that explanations of social institutions should invoke distributional effects does not imply that such institutions do not provide some measure of collective benefits (1992: 17).

Many other examples could be mentioned with regard to Knight's contribution. For example, Knight mentions that these distributional aspects are key factors not only for explaining many of the institutional reforms that we finally see approved in today's democratic societies, but also to "explain how manipulation of electoral institutions took place in the assemblies of Rome" in the fourth century B.C. (1992: 194). Since the right to vote and representation in those assemblies were organized along tribal lines, electoral results could easily be changed by just modifying the requirements for being a member of each social stratum. So, in the year 312B.C., when Apius Claudius wanted to give more influence to urban merchants, he simply tried to reform the electoral law to allow the residents in the four large urban districts to register as voters in the districts or areas of their choice, regardless of their place of residence. Several years later, writes Knight, the law was once again changed to require that urban voters exercise their electoral rights in the urban districts where they resided, again making it possible for those who were trying to preserve the primacy of agrarian interests in the Rome of that time to be the majority in their districts, thus recovering for a time the institutional framework that favored them.

The interest of North and other new institutionalists in these issues is also manifest in the invitation to Jack Knight to publish his impressive 1992 doctoral thesis, *Institutions and Social Conflict*, as part of the "Political Economy of Institutions and Decisions" series edited by James E. Alt and Douglass C.

North, or that Knight and North published “Explaining the Complexity of Institutional Change” in 1997, an article in which the two authors emphasize these aspects.

Some of Barry Weingast’s contributions can also be cited as examples of analyses in which distributional aspects are taken into account, although tangentially.[9] So, for example, in the oft-quoted, classic articles by Weingast and Marshall (1988) and Weingast (1989), the authors mention that control over the agenda of U.S. congressional committees implies that each committee has veto power over proposals that will be put to the vote on the floor. This control of the agenda allows the committees to guide the result of the decisions toward the alternatives preferred by the majority of each committee’s members, who remain in their positions as long as they continue to be reelected. Distributional considerations are present, then, in this analysis. The diversity of interests among legislators, according to Weingast, creates opportunities for mutual benefits and the exchange of support among committee members. But, Weingast and Marshall point out that a system of exchange of favors and support on the floor of Congress would pose more risks of possible incompliance than the current committee system in the U.S. Congress. It is necessary to mention here, however, that the main concern for these authors is, naturally, determining if this system is more efficient than the other in the sense that it generates lower transaction costs for legislators in their recurring task of reaching agreements about the legislative measures that should be adopted, *ceteris paribus*. Their answer is yes, given that if legislators are ultimately seeking reelection in their own districts, they will prefer this system to the traditional system of episodic support or votes because it would ensure more than the other that what has been agreed upon is actually what happens; this would make it possible to ensure passage of each legislator’s own proposals to the benefit of their constituents with lower transaction costs.

Given that current support for a bill is a sure thing, while the promise of future support could go unfulfilled for many reasons (among them, the circumstances that gave rise to the pact could change, as could opinions with the passage of time), it seems obvious that legislators will prefer the system that will best ensure promises will be kept. According to Weingast, neither issues of reputa-

9 Weingast (1989), North and Weingast (1989), Weingast and Marshall (1988), or Horn (1995) can all be cited as examples of these works.

tion nor the fact that the interaction will be repeated can prevent agreements being broken under certain circumstances. The existing diversity of interests among legislators facilitates coming to agreements for the mutual benefit of the respective constituents, but the traditional system of episodic exchange of support or votes creates much more uncertainty about the final result, and therefore, greater transaction costs than the aforementioned committee system, given the permanent possibility of incompliance or of demands to renegotiate as a result of changes in context or opinion. The gradual general acceptance that this was the case led to the approval of changes in congressional rules that allowed the new system with hardly any opposition.

These authors developed a model with an ideal committee system, arguing that the empirical evidence of how the U.S. Congress worked did not refute the model. In it, the legislative committees are formed by certain seats. Each seat belongs to an individual congressperson, who owns it. Assigning it is based on the seniority system and gives the congressperson the right to remain in it as long as he/she desires. Each committee is assigned a group of issues on which it has the exclusive right to propose actions and reforms to be voted on the floor. When a seat is vacated, it will be filled using a technical procedure consisting of seeing who the oldest congressperson is who previously requested it in his/her written statement of preferences for committee seats. The control of the agenda, that is, which bills will be sent to the floor for a vote and when and how, gives the committees a veto over the proposals that other congresspersons might make to the committee and biases the process toward introducing the bills most supported by committee members. Therefore, it is by no means strange to see how congresspersons from rural districts put at the top of their lists the committees involving agrarian issues and not, for example, the committees dealing with housing or the merchant marine. The stability of alliances and agreements inside a committee or among members of different committees is reinforced by the prevailing system ensuring ownership of the seats.[10] As we will see in the next section, the institutionalization of this system of exchanges and support is not, therefore, neutral either in terms of overall results or in terms of the distribution of the benefits resulting from the legislative and budgetary activities finally approved by Congress.

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[10] A comparison of this organization with how legislative work is carried out by the Spain's deputies can be found in Caballero (2006; 2001).

All these articles and books are only examples of the analyses developed by outstanding new institutionalists. But others could be mentioned, among them Libecap (1989a; 1989b), Winiecki (1994; 1996; 1998), Bardhan (2000; 2001; 2004; 2005), Greif (2005; 2008), Nye (1997), or Mokyr and Nye (2007). Even in the field of industrial-entrepreneurial organization, examples of analyses by outstanding new institutionalists could be cited in which distributional aspects, negotiating strength, or the degree of hierarchical control are focused on as central aspects. Thus, Williamson (1996a; 1996c; 1997) or two works by the third president of ISNIE, Ménard (1997; 2004) are other examples. Both authors even refer to the "influence of power" among people who emerge from existing hierarchical relationships within companies, institutional structures necessary for ensuring control over assets.

The conceptualizations and methods habitually used by the new institutionalists have broadened out so much over recent decades that it is not strange to encounter work by self-proclaimed new institutionalists in which reference is made to situations where, for example, certain groups of people might oppose a reform considered efficient to the extent that it could contribute to reducing transaction costs if they think that it will affect them negatively in distributive terms.[11] In this sense, Horn (1995: 16) writes: "if enacting legislators' commitments, as well as the benefits provided to their constituents, are uncertain when subsequent legislatures come, they may have an incentive to protect those benefits by even attempting to implement inefficient institutional arrangements that increase the transaction costs of reversing those policies." It is important to mention that Horn's book was published as part of "The Political Economy of Institutions and Decisions" series, edited by James E. Alt and Douglass C. North.

This concern with distributive issues is also evident among the new institutionalists who have made contributions to the analysis of institutional reform processes in the countries of Eastern Europe. Since the aim of this article is not to do any sort of survey, suffice it to mention some of Winiecki's most outstanding works, several of which have been presented at ISNIE congresses.[12] Winiecki's

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[11] See Libecap (1989a; 1989b), Greif (2005), Winiecki (1996), and Bardhan (2000; 2001).

[12] Several of these can be found in the last volumes of the *Journal of Institutional and Theoretical Economics*, particularly volume 156, issue 1, from March 2000, dedicated entirely to publishing the papers presented at the 18th International Seminar on the New Institutional Economics, "Big-Bang Transformations of Economic Systems as a Challenge to New Institutional Economics."

works of 1998, 1996, 1994, 1993, and 1991 can be mentioned as examples because, together with his thinking about efficiency and transaction costs, he also pays attention to the distributive issues associated with the object of study.

In Winiecki (1986), he explains the legacy in informal institutions that centrally planned systems have contributed to the process of transition, while in his 1998 work, he underlines the importance that informal institutional frameworks have for the success of any legal reform aimed at installing Western-style market economies in the countries that formerly had planned economies. To the extent that the sets of norms, values, routines, and habits learned and exercised for decades in the framework of the Communist systems are clearly different from the values and habits required for the orderly functioning of market economies, and given the greater difficulty of adapting those social norms and habits when they have been strongly internalized in people's mental structures, Winiecki considers that it is to be expected that during the transition period in these countries, there will be high transaction costs compared with the situation in economies of similar economic backwardness but that have formal and informal institutions that correspond to democratic societies with market economies. This continues to be hypothetical-deductive reasoning that is difficult to contrast, but Winiecki contributes hefty arguments to support his affirmation.

He states that those high transaction costs are to a great extent due to factors related to the existence of specific informal institutions and the impact they have on the efficacy of and compliance with the other legal frameworks in place. In the first place, to the extent that the high level of discretion in enforcing existing legislation in the former Communist systems continued to exist, that social practice or norm (an informal institution) led to the development of specific legal norms with deliberately vague wording. According to Winiecki, making potential specific situations compatible with general principles and rules has not only made those norms less effective for regulating, but has even sometimes rendered some general principles inoperative. The successive changes to these legal texts in order to make them coherent and at the same time preserve a certain degree of discretionality often gave rise to frenetic reform activity. In his 1998 work (p. 5), Winiecki gives the example of how in Hungary from 1994 to 1995, the fiscal norm in the tax code was changed 91 times. The imprecise and changing legal framework that existed for all those years increased transaction costs of all the activities subject to those regulations. Familiarizing oneself with the new norms and studying the available alternatives requires time, effort, and expense that will be greater if these norms change frequently. Just like economic agents, judges, lawyers, city councilpersons, journalists, etc., are all affected by this. Obviously, the change in the legal framework can also bring with it strictly economic losses as the result of decisions that turn out to be disadvantageous for most participants given the new context.

In the second place, Winiecki writes, the social values and habits that prevailed under the old, *despotic* regime directly or indirectly primed people to behave strictly opportunistically: theft, tricks, fraud, absenteeism, cronyism, and the rest of it. The ethics of effort and work was seriously damaged, according to this author, and these values and practices will tend to last over time, exceeding even the transition periods. Once again, this will make existing transaction costs much higher than they would be in democratic market-economy countries immersed in profound processes of legal reform but where the ethics of effort and work and respect for norms (as informal institutions) are widespread.

Winiecki (1996) using North and Olson's works as references, among others, to show how institutional reforms that privatize and introduce market rules in these countries represented an explicit change in the rules of the economic game,[13] thus affecting the existing transaction costs but also causing enormous distributive impacts. For Winiecki, these foreseeable distributive impacts were one of the main explanatory factors of why specific groups opposed these economic reforms. To the extent that the power and hierarchical status acquired in the old system of planned economy and bureaucratic leadership of the economy was generally associated with higher incomes, rents, and other economic privileges, the predictable loss of power and status derived from these reforms is just as predictably going to be the cause of a loss of income and other economic privileges. This makes it possible, says Winiecki, to center the analysis on these last economic consequences, considering said positions of power to be instrumental.

What groups, then, displayed greater resistance to the liberalizing, privatizing reforms? Leaving to one side the groups of workers and their unions that belonged to sectors or regions where the predictable or already real increase

[13] The basic rules of the democratic political game and competition among political elites were the first to change in successive Constitutions and the legal rules that develop and concretize those constitutional principles and norms.

in unemployment was most evident, those who resisted the reforms the most were, according to Winiecki, the former members of the Communist Party (CP) apparatus who held positions of control in different municipalities, cities, and regional, county, etc., committees, as well as the former company bureaucrat/managers. And this was because these were the groups that had the most to lose in terms of power positions that they had enjoyed in the previous institutional framework, and consequently, in terms of the rents and other economic privileges associated with the same. With privatization and the new market rules, many of them joined the ranks of the unemployed.

What pecuniary advantages had the members of the CP apparatus and economic managers enjoyed that they would not be able to maintain under the new institutional framework that the reforms were introducing. In his institutional analysis, Winiecki underlines fundamentally two. In the first place, the members of the apparatus had the ability to propose/decide who was going to be appointed to the different leadership and managerial positions in companies and other state bodies. They exercised this power fundamentally using the criteria of loyalty and family ties. Different acquaintances and relatives, including spouses and children, acceded to positions of responsibility, explicit earnings, and other indirect economic compensations and benefits that that they would not have enjoyed if not for their appointments. Or, they found jobs after being recommended as candidates for hiring for the most diverse tasks. This right to make appointments was known as the *principle of the nomenklatura*. Each individual's loyalty to the person or persons upon whom he/she felt dependent and grateful for his/her employment, plus the formal compliance with the orders received from the leadership and management, led in innumerable cases to the falsification of reports about the situation of production and the accounts presented to the higher-ups to prove compliance with the agreed-upon plans, to the formal satisfaction of both parties.

The second method for appropriating income or economic benefits by CP apparatus leaders, both in the former Union of Soviet Socialist Republics (USSR) and in in the countries of Eastern Europe, and that the reforms endangered is the also well-known mechanism of payments in kind. According to Winiecki, public company managers habitually channeled to their patrons and other people who could possibly advance their political careers goods and services from their companies at a big discount or at a price much lower than what they could be sold for on the black market, or even free of charge. For example, they might simply send workers to build or expand a private chalet or repair the woodwork of a home without logging the labor in as part of the services provided by the company. About this, Winiecki (1995: 68) writes, "The relative unimportance of efficiency allows managers to absorb, without being held accountable, the costs of these kickback activities. [. . .] Both types of rent extraction exist because of the muddled structure of property rights in the soviet type enterprises." Obviously, these payments in kind are also habitually granted among managers of different companies. It is no surprise either to note, as Winiecki does, that many top figures in the apparatus fought for top posts in state companies.[14]

With the replacement of the old institutional framework and the decentralization of decision-making that privatization implied, these possibilities of obtaining rents and economic benefits decreased drastically, and the efforts to improve management and save all types of costs also rose as competition increased across the entire system and external financing stopped being a bottomless pit and became a financial cost.

So, it is not surprising that resistance to the reforms was great among the members of these collectives and that the causes of the failure of many of the first bills put into effect during the 1990s can be found in these groups' actions and strategies. Even in the cases in which those reforms were passed by the legislature, their implementation was in the hands of these members of the apparatus and economic managers, who could make them fail by indirect methods.

It should be obvious after reviewing what has been said until here that outstanding authors who say they are working in the tradition of the new institutional economics do pay attention to distributive issues in some of their contributions. For these authors, it is clear that institutional arrangements also have a significant impact on who gets what and how much in any sphere of decision-making. With regard to team efforts, it is also clear to these new institutionalists that the formal and informal rules for organizing them have an influence on the efforts and costs for each participant in this common effort.[15]

In the same sense, it is accepted among these authors that even if total transaction costs were decreased by a specific institutional reform, that does

[14] Winiecki (1986: 70) mentions that in Poland as well as other countries in Eastern Europe, these groups benefitted from coupon (*asygnata*) that allowed them to acquire automobiles for private use at less than half their normal sale price.

[15] Other works by new institutionalists along these lines can be found in Harris, Hunter, and Lewis (1995) as well as the works published in Alston, Eggertsson, and North (1996).

not guarantee that there would not be participants who would be negatively impacted *vis-à-vis* distribution. This means that it should be expected that efficiency improvements will be defended more vigorously by those who hope to gain from them one way or another than by those who could be hurt by them. It is predictable that the latter will try to oppose or reorient them with greater or less determination depending on, among other factors, the known costs associated with collective action.

The usefulness of the Edgeworth-Bowley box instruments once appropriately modified

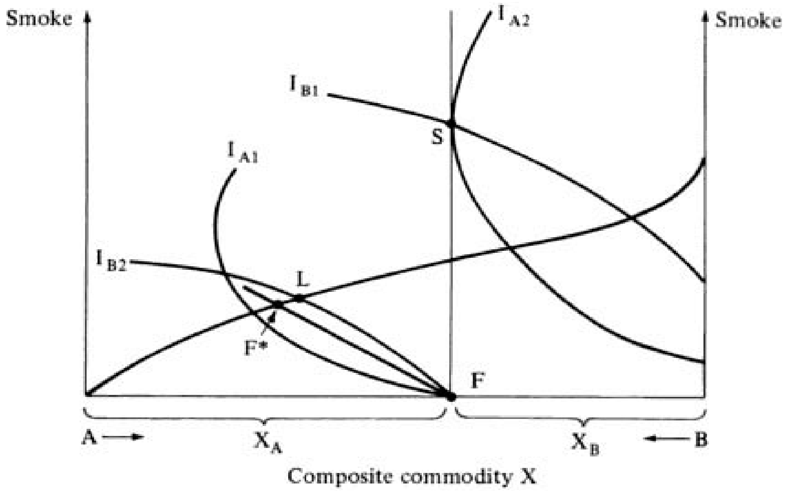
The foregoing comments and quotes reveal that, in effect, it is no longer possible to say that the new institutionalists continue to disregard distribution questions. The fact that in the framework of other currents of institutional analysis or that among researchers who belong to one or another current of political analysis special attention is paid to these distributive factors is evident. However, it is not the aim of this article to examine those other contributions. To complete the aims of this article, it is necessary to take one more step forward to show that these distributive considerations tied to the existence of different institutional frameworks or their reform can be linked together through a fully unorthodox, highly persuasive microeconomic analysis.

To do this, it is necessary to make a small modification in the now-classic Edgeworth-Bowley box graphic instrument so familiar to economists. Though designed to emphasize the benefits derived from voluntary exchange, this tool can be adapted to very persuasively show the distributive dimension always present in those transactions under different instititutional frameworks, which can also be reformed. Instead of considering a potential exchange of two private goods (goods, services, and/or money) under stable rules of the game, the box has to be modified to allow the incorporation of an activity that generates external effects and leaves open the possibility of a change in the legal-institutional context in which the participants interact. This means that the traditional Edgeworth-Bowley box must be designed open at the top, that is, without a roof, while maintaining all the other analytical-methodological concepts and assumptions.

It was Eggertsson (1990), president of the ISNIE after Ménard and the Nobels for Economics Coase, North, and Williamson, who published what was, as far as we know, a pioneering Edgeworth-Bowley box without a roof. In his book, Eggertsson mentions a paper for a congress prepared by Haddok and Spiegel. Granted, Eggertsson does not use the reformed box for to the same end that I am here, but rather to emphasize that the potential benefits of exchange in a volunteer market could not be effective if transaction costs were so high as to make it unviable. In such cases, says Eggertsson, the efficiency of these interactions could be greater if the institutional framework were reformed in the direction of reducing those obstacles and the transaction costs associated with them, thus creating an incentive for a greater number of market exchanges. And he gives examples. For example, he writes, "introducing individual marketable quotas in ocean fisheries."[16] The author clearly adopts in his book the predominant approach at the time, and even today in the tradition of the new institutional economics, focusing his analytical/research effort on how institutional frameworks influence transaction costs, efficiency, and economic growth.

Graph **1***

Institutional framework, transaction costs, and distributive aspects



Notes: */ Smoke: smoke in the room. Price of smoke: price of the exchange to achieve more or less smoke in the room. Composite commodity: any private, interchangeable good or basket of goods. I: the habitual indifference curves in the Edgeworth-Bowley analysis.
Source: Eggertsson (1990: 106), who refers to a paper by Haddock and Spiegel.

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16 Although Eggertsson's aim in those pages is not focused on the distributional aspects, on page 109, he briefly writes, "the assignment of property rights to an individual produces a kind of wealth effect that influences his or her valuations."

Although the analytical concern is different, it is a good idea to first summarize Eggertsson's graphic analysis with the reformed box in order to underline this work's innovation. In Graph 1, Eggertsson (1990: 106) presents the reformed Edgeworth-Bowley box. In it, two agents interact in a shared space. An exchangeable private good —or, if you will, a basket of goods— is also represented in the amounts indicated for both agents (person A has X_A and person B, X_B), as well as an activity that creates negative external effects for one of the participants, since one is a smoker and the other is not. The level of smoke is measured on the vertical axis.

Even though in this graph, Eggertsson does not given them an explanatory name, it does also contain two alternative legal-institutional frameworks in order to carry out the usual static comparative analysis, *certeris paribus*. As I will show in Graph 2, one of those frameworks allows smoking (the right side of the graph, for reasons that I will explain below), and the other institutional frameworks does not (left side). Using these mutual advantages of the voluntary exchange for both agents, says Eggertsson, requires graphically that the participants move from S to S* or from F to F*, depending on the initial assignation of decision-making rights about smoke in the room. That assignation will depend on the legal framework in effect, as we will see here. If the transaction costs derived from that negotiation are low, it will be possible. If they are high, says Eggertsson, they may not compensate one or both participants.

But, as I just mentioned, it is not the transaction costs, the efficiency, and the profits of the exchange, given the starting situation, that are intended to be underlined in this last part of the work.[17] Quite to the contrary, what is intended is to reveal how important and omnipresent distributive aspects and considerations are in these same situations, where voluntary exchanges seem to be an option. And also, that those distributive results depend to a great extent on the institutional frameworks in effect, *ceteris paribus*.

Those institutional frameworks are not neutral from a distributive point of view because they impact on the initial assignation of participants' rights and decision-making and negotiating capabilities. And this is always the case, regardless of the size of transaction costs resulting from one or another institutional regulatory configuration for individual interaction or negotiation for collective or political decision-making. Changing those institutional structures and the

[17] About these aspects, see Eggertsson (1990: 105-7).

rules of the game they determine has consequences not only for transaction costs and total production costs for the participants as a whole (the degree of global efficiency), but also for the distribution of the benefits derived from those reforms, benefits measured in terms of current and future rent and wealth levels that each will achieve, *ceteris paribus*.[18]

Institutional change and distributive impacts: a graphic analysis

Graph 2 is very useful for emphasizing these distributive aspects. It also represents a very stylized, simplified situation, as in the case of the previous graph. In short, the main aspects of this new situation are as follows: in Graph 2, the same two persons are represented as in Graph 1 (A and B), both of which are supposed to be concerned solely about their own interests. Both have to work in the same badly-ventilated room with no one else around. For the purposes of the analysis, a very simplified institutional framework is a given, with a single legal rule. Both participants possess a certain quantity of an exchangeable private good or basket of goods, as indicated in the graph as an example. This stylized situation also has an external effect (the smoke level is generated in a shared room) that negatively affects the well-being of the non-smoker (B) and is generated by the smoker (A) when he/she subjectively calms his/her tobacco addiction.

Graph 2 also includes the same two alternative legal-institutional frameworks that we will now denominate IF_1 and IF_2, as shown. IF_1 (legal rule: smoking allowed) implies taking into consideration the right side of the box since the legal rule, which we will detail below, gives the smoker the ability to decide his/her initial starting situation (the initial level of smoke in the room), as well as greater negotiating strength for influencing the terms of the possible later exchange. To look at the other possible institutional situation denominated IF_2

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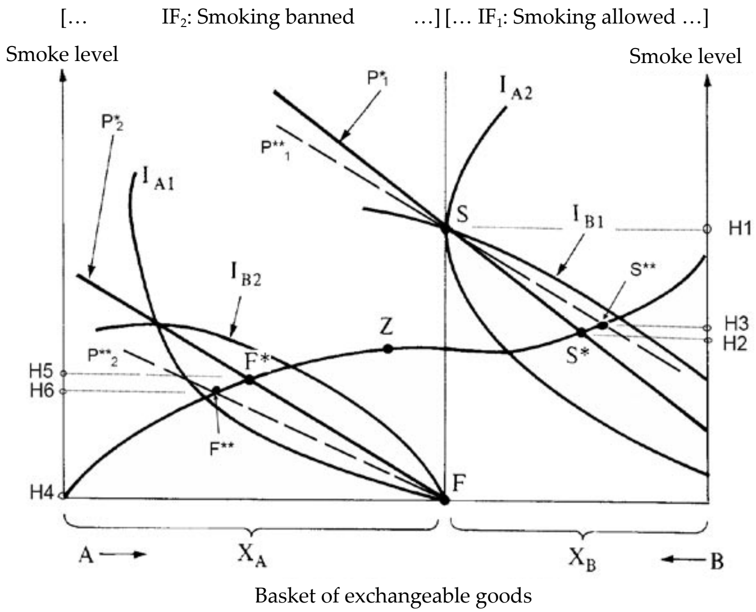
[18] In order to concentrate the analysis on the aspects that I want to underline here, obviously many other institutional and non-institutional issues are not taken into account. In this case, for example, of those referring to the possibility of some participants being able to have the right as players with veto power. Given that the stylized analysis that our graphic presentation permits is in addition static and comparative, all aspects related to the causes and process that lead to the institutional reform are also left out. About actors with veto power and other specificities linked to the embedded political processes in which these collective decisions are normally made, see Tsebelis (1990; 2002).

(legal rule: smoking banned) requires examining what is on the left side of the box starting with the vertical line marking the initial distribution of the private good we have supposed for the analysis because, as we can now see, in that case, it is the non-smoker who has the right to decide the initial level of smoke, so the new legal framework gives him/her greater negotiating strength.

The habitual maps of indifference curves for each agent are represented as I_A and I_B. As commonly known, each indifference curve attempts to represent the alternative combinations of good X and the level of smoke (cigarettes consumed by the smoker) that will make each participant subjectively feel equally satisfied. For that reason, these curves must be drawn traditionally and continue to face in the opposite direction.

Graph **2**

Graphic analysis of the distributional impacts of institutional change



Source: developed by the author based on Eggertsson (1990:106).

In this stylized example, and using the habitual *ceteris paribus* clause, if legislation allows smoking (IF_1), it is the smoker who has the right to initially decide the amount of smoke that will exist in the shared room. This means that, in principle, he/she could smoke as much as he/she wanted if not limited by any important budget constraints given the small expense this involves. And the other person, the non-smoker, would be in a smoke-filled workplace. Utilizing the usual concepts of the Edgeworth-Bowley box graphic analysis, we suppose that both participants have potential indifference curve maps that are more or less standard, such as those in Graph 2, for example. Other different conditions could be supposed, of course. Given the analysis's conceptualizations and suppositions, if the initial distribution of X were the one indicated on the graph (X_A, X_B), the existing institutional framework IF_1 could initially lead (if person A is only concerned about him/herself and is a heavy smoker, *ceteris paribus*) to point S. This would mean that the smoker would be positioned higher on the indifference curve (IA_2), which he/she can achieve in the stylized circumstances presented here. Non-smoker B would then have to deal with very different conditions for his/her well-being or utility, since he/she would be in a room with high levels of smoke. This would have to be represented by situating that person on the indifference curve on the lowest possible point on the diagram (I_{B1}), given the other assumptions in this super-stylized analysis. If there were any impediments for them to be able to talk and come to some kind of voluntary agreement, these would be the final conditions, with person B having very low levels of utility due to a high level of smoke (H1) in the shared room.

If the two participants do not act in this short-sighted way, a quite common behavioral assumption in many introductory maximizing economics manuals *à la* Robbins, but rather (changing some of the implicit suppositions in the foregoing analysis) were open to dialogue and exchange, it is reasonable to think that they could come to an agreement even if each is only thinking of his/her own short-term benefit. If we used the initial conditions S as the starting point (which IF_1 and the other suppositions in the analysis could lead to), it is reasonable to think that the directions and terms of that possible change would require that non-smoker B would have to pay the smoker for him/her to smoke less. How much would the non-smoker have to pay for each cigarette that the smoker did not smoke? That would certainly also depend on the other factors not considered in this stylized analysis, for example on each person's background and the relational circumstances they might have been involved in in the recent past or on how good they were as people depending on each one's ethical, moral, or religious principles, or, for example, depending on the greater or lesser extent to which each one included the other's well-being as a variable of his/her own utility function. Not to mention many other factors that could have an influence, such as their different negotiating skills or ability to make alliances outside the office.

But all this and much more is deliberately included in the *ceteris paribus* of the graphic analysis presented here. That is, it is all excluded from consideration to be able to focus the attention on the few aspects that I want to underline here. Remember that Graph 2 is a revision of the classic Edgeworth-Bowley box in order to emphasize the distributive dimension associated with the existence of different institutional frameworks, as well as the distributive impacts created by institutional reforms.

And with regard to the possible exchange that could emerge from initial conditions S, Graph 2 shows, first of all, hypothetical intermediate conditions in which both parties' negotiating strength is quite similar or balanced (that I will detail further down), but it also shows other hypothetical conditions in which the two agents' negotiating strength is unequal. The price of a hypothetical balanced exchange, which the participants might be able to arrive at in an institutional framework in effect defined by IF_1 would be represented by P^*_1. The smoker could reduce the level of smoke from H1 to H2 while the non-smoker would transfer to him/her part of his/her private good. But, the possibility of a more unequal exchange is even more probable than in the previous case. The terms of exchange could be, then, more favorable for the smoker, who is in the best negotiating position under the existing legal framework and the other givens of the analysis. P^{**}_1 would reflect that second possibility with a more unequal exchange. The point S^{**} would represent the final conditions after said exchange, in which the smoker would end by smoking more than in S^* and would obtain more of good X.

But, what would happen if, exogenously to our analysis, there were an institutional reform banning smoking? In our simplified graphic analysis this would be the equivalent of changing from a situation with an institutional framework like IF_1 to another with an institutional framework like IF_2 (smoking banned). And this would also make for a drastic change in the parties' rights and negotiating strength, two of the basic elements considered here. In these new and equally sterile circumstances, the non-smoker would become the one to have the initial right to decide the smoke levels in the room. And with the givens of our analysis, he/she would normally be expected to choose zero smoke in the room. Point F would represent those new conditions. The level of satisfaction or well-being of both participants would change drastically with regard to what would happen in the initial conditions created by the previous institutional framework (smoking allowed), as is reflected in the new indifference curves in which both are situated after the approval of the new institutional framework (IA_1, IB_2). If we again relaxed the givens of the general analysis and made it possible for the agents to somehow bypass without cost that prohibition, it is normally to be expected that now it would have to be the smoker who would pay the non-smoker for him/her to let the former smoke a cigarette at certain times in exchange, naturally, for giving him/her part of good X in his/her possession. The direction of the monetary or in-kind payments would also be drastically changed due to the simple fact that the institutional framework has changed.[19] Again, if we presupposed similar negotiating power, the price of the exchange could be represented as P^*_2 and the possible result could be graphically represented as point F*, conditions comparatively better for both participants than that previously reflected by point F. But, as mentioned above, the institutional reform often also changes the two parties' negotiating strength. And in the new institutional conditions and the new initial conditions created, it is the non-smoker who now has much more negotiating clout than the smoker, compared to the previous institutional conditions, for reasons that it is not appropriate to go into here. The price of this more unequal, and in this case more favorable to the non-smoker, exchange would be P^*_2. The final circumstances, after this hypothetical new equally "voluntary" exchange, given the institutional circumstances and others, would be represented in our graphic analysis by point F**. That is, the smoker would smoke until he/she generated H6 level of smoke instead of that represented by point H5, which would be the result of supposing that the two parties had balanced negotiating strength. In this case, the smoker would also end up with a lower amount of good X than that which he/she would have if a more balanced negotiation were the given.

It is obvious that this very orthodox graphic instrument, conveniently modified, makes it possible to show simply how the existence of one or another institutional framework has important distributive consequences because it affects the agents' initial rights and decision-making capabilities. By also in-

[19] Although no mention is made of it in the relevant literature, it is clear that this is a example similar to that of the polluting factory and the city council popularized by Ronald Coase. But, in this case, I emphasize the differential distributive impacts derived from the initial conditions.

fluencing the participants' relative negotiating strength, both if they act alone and if they act in concert, it is clear that the legal rules that make up the two markets (institutional frameworks) undoubtedly influence —among many other factors, of course— the prices of the possible "voluntary" exchanges that take place under the different existing institutional frameworks. They are "voluntary" given the circumstances, of course. The sterilized graphic analysis of comparative statics presented here does not, however, allow us to go into issues linked to collective action or political action in concert. Nor have I more than barely highlighted how they can also influence the web of norms, values, customs, and social habits that we refer to as informal institutional frameworks.

Conclusions

The arguments and quotes in this article show that, although the concern for efficiency and transaction cost issues continue to predominate the work of the new institutionalists, several outstanding authors have paid increasing attention to the dimension of distribution. This is the case of the works mentioned here. The expansion of the approach that took place in the 1980s and 1990s, and which served to distance those contributions from traditional neo-classical positions, is thus being broadened in turn in the direction of incorporating distributive aspects.

Together with the foregoing, the second new contribution of this article has been to modify the Edgeworth-Bowley box graphic instrument to show in a very persuasive and unorthodox fashion the ways an institutional reform generates important distributive consequences in addition to influencing the total transaction costs paid by participating agents in that institutional framework. As this article has emphasized, it was in Eggertsson's book (1990) that for the first —and also the last— time that a box modified in this way was published, as far as I know. However, in his book, Eggertsson does not use that modified box for the same end as I have here, but to emphasize that the potential benefits of voluntary market exchange could be ineffective if transaction costs were high enough to make it unviable.

Here, what has been shown, in contrast, is how the rules of a specific institutional framework can make certain agents incur higher transaction costs than would derive from their non-existence (and even pay a higher price as a result), while others find in those rules the mechanism that would allow them to demand and obtain —at least in the short run— greater earnings or rents, and even compensate them for the higher transaction costs that they would have to incur as a result of the necessary negotiations if that were the case. We must, then, obviously also conclude that political action aimed at reforming those institutional frameworks is often very influenced by the distributive impacts that each group of participants expects from the alternative reforms.

A change in labor legislation, for example, in order to introduce different kinds of temporary hiring where this does not exist would undoubtedly make greater organizational flexibility possible in the sphere of business organization, thereby, for example, decreasing the transaction costs associated with reorganizing work, firings, the negotiation of severance pay, etc. But this would have very different consequences in distributive terms for the different participants directly affected by the reform. The institutional changes or reforms affect the rights, the decision-making capabilities, and the relative negotiating strength of the parties involved.

Even if total transaction costs were decreased by a given institutional reform, this would not guarantee that distribution to certain participants would not be negatively affected. This is why it is to be expected that improvements in efficiency will be more defended by those who hope to gain by them one way or another than by those who expect to be injured by them, who would oppose them or try to reorient them in a more favorable direction, with greater or less determination depending, among other factors, on the known costs associated with collective action, which in this graphic analysis have not been taken into account.

On the other hand, all these distributive considerations that are now gaining more and more ground in contributions by the new institutionalists are habitually dealt with in publications by other analytical currents, both economic and political. The objective of this article has not been to make any forays into those other contributions, but rather to show, first of all, that these aspects are also present in the field of the new institutional economics, and secondly, that these ideas and arguments, traditionally held as unorthodox, can be explained very persuasively using a very orthodox graphic instrument once it has been appropriately modified.

Since the power of ideas is not independent of the way in which arguments are constructed and expressed, I maintain that the modification used here of this graphic instrument (popularized by Vilfredo Federico Damaso Pareto and

Arthur Lyon Bowley based on the pioneering contributions of Ysidro Edgeworth more than 100 years ago) is of maximum importance. The students of the doctoral course on institutions and economic behavior that together with other colleagues I have been teaching in recent years concur. The idea that "institutions also influence distribution, not only efficiency" is very, very clear to them. Let the following idea —not recent, by any means— serve to underline that more and more new institutionalists are paying attention to these issues. At the beginning of the 1990s, Libecap (1993: 32) was already saying that these aspects influence the incentives of each of the negotiating parties in a process of institutional change and, therefore, the result of the negotiation. He went on to say that that the distribution of wealth and political power are usually always at stake and that the normal outcome of reform is the emergence of winners and losers.

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