Institutionalism: Old and New

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This chapter is about how and why institutions matter in political life. More specifically, it is about how the behaviour of political actors is shaped and conditioned by the institutional contexts in which they operate. This perspective and question define the central concerns of the so-called ‘new institutionalism’ in political analysis.

As a discipline, political science has always been able to legitimately claim that the study of two things, power and institutions, have been at the core of its concerns and contribution. Institutions are important, because, as entities, they form such a large part of the political landscape, and because modern governance largely occurs in and through institutions. Institutions also matter because they (or at least actors within them) typically wield power and mobilise institutional resources in political struggles and governance relationships. Institutions are also said to matter because they are seen as shaping and constraining political behaviour and decision making and even the perceptions and powers of political actors in a wide range of ways. Hence, in institutional terms, students of politics have analysed party systems, the rules of electoral competition, government bureaucracies, parliaments, constitutions, the judicial system, as well as large institutional complexes made up of the government and the gamut of public institutions we call the ‘state’ (Bell and Head 1984 ch 1; Fenna 1998: ch 2). There have also been extensive studies of supra-national institutional complexes such as the United Nations, the European Union and other international institutional regimes that help regulate economic relations, the environment or international trade (eg the World Trade Organisation). There have also been studies of ‘non-state’ institutions such as business corporations and trade unions.

Although debate continues on how best to define institutions and institutional boundaries, it is probably best not to think of an institution as a ‘thing’ but as a process or set of processes which shape behaviour. My dictionary defines an institution as ‘established law, custom or practice’. The reason why institutions matter is that laws, customs and established practices in institutional and organisational settings can play a powerful role in shaping the behaviour of individuals. There is broad agreement that in defining institutions in these terms we need to focus not only on formal institutions and practices but also on informal routines or relationships. Levi (1990: 409) argues that ‘the most effective institutional arrangements incorporate a normative system of informal and internalised rules’. North (1990: 36) agrees and argues that the most significant institutional factors are often informal:
In our daily interaction with others, whether within the family, in external social relations, or in business activities, the governing structure is overwhelmingly defined by codes of conduct, norms of behaviour and conventions. Underlying these informal constraints are formal rules, but these are seldom the obvious and immediate source of choice in daily interactions.

Note also that there is no sharp analytical distinction in the above discussion between ‘institutions’ and ‘organisations’. One difference between institutional arrangements, such as ‘federalism’ or ‘competitive electoral systems’, on the one hand, and specific organisations such as the Australian Medical Association or the Reserve Bank of Australia, on the other hand, is that the former are broader in scope and more diffuse sets of institutional arrangements. But analytically, there is not a large distinction between institutions and organisations, with the latter best seen as nested within and shaped by wider institutional arrangements. North (1990a: 396) argues that ‘organisations are a response to the institutional structure of societies’. A good example would be the way in which wider institutional parameters, such as the system of electoral rules and the intensity of party competition, shape the role and functioning of specific organisations, such as the Australian Labor Party. North (1990a: 396) also argues that the actions of organisations are a major cause of the alteration of the wider institutional structure. For example, the ALP might strive and campaign to alter the rules and institutional arrangements of electoral competition. In this sense, institutions can be defined as anything from formal organisational arrangements to forms of patterned behaviour operating through roles, rules and (partially) scripted behaviour. For North (1990: 4) an institution is ‘any form of constraint that human beings devise to shape action’. This might involve formal constraints, such as rules, or informal constraints, such as conventions, norms or codes of behaviour. Hall (1986: 19) defines institutions as ‘the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units in the polity and economy’. Similarly, March and Olsen (1989: 160) emphasise that the main impact of institutions in political life stems from the fact that they are:

- collections of interrelated rules and routines that define appropriate actions in terms of relations between roles and situations. The process involves determining what the situation is, what role is being fulfilled, and what the obligation of that role in that situation is.

Compliance with institutional rules, norms or operating procedures might be voluntary or subject to various monitoring and enforcement practices. Despite his emphasis above on the importance of informal arrangements and voluntary compliance, North (1990a: 384-85) also emphasises the importance of formal rules and of the monitoring and enforcement mechanisms required to sustain or underpin them.

Writers such as Levi and Hall go beyond this theme of institutional constraint or obligation by arguing that institutions are important because they also shape the power and preferences of actors. Levi (1990: 407) argues that institutions both contain and create power, whilst Hall (1986: 19) argues, ‘the organisation of policy making affects the degree of power that any one set of actors has over policy outcomes’. For example, Treasury officials, because they operate at the very centre of the government’s bureaucracy and influence critical resource flows associated with government expenditure are more powerful than, say, officials in the
department of Veteran’s Affairs. Hall (1986: 19) also argues that ‘organisational position also influences an actor’s definition of their own interests, by establishing institutional responsibilities and relationships to other actors’.

So, broadly speaking, institutions are important because they shape or influence the behaviour, power and policy preferences of political actors. The emphasis here on shaping and influencing implies that institutional dynamics, whilst often important, do not explain everything. The preferences and resources of political actors might be drawn from a number of sources. Also, institutionalism is a ‘middle-range’ theory because institutions can be thought of as standing above actors but below wider ‘structural’ forces in politics (Pontussen 1995). These broader structural factors include, for example, the impact of class forces or the impact of the domestic or international economy on politics. This raises the question of where to draw the boundaries of institutional factors; particularly since it is clear that macro-level structures, such as class relations, also clearly impact on behaviour. Ultimately, the distinctions here are analytical in nature. It is useful to distinguish between institutional and wider structural factors, particularly since the former often play an important role in shaping and mediating the impact of the latter (Steinmo and Thelen 1992: 11). For example, class forces are important in all capitalist societies, but the actual impact of such forces will be mediated by the institutional make up of the state, by the nature of trade union organisation or by the dynamics of party competition. Another example is that the impact that international economic pressures have on national policy will be affected by a country’s economic structure and also by the institutional capacities and make-up of the state. In this respect Tsokhas (1995) tells an interesting story about how the impact of British financiers in shaping policy responses to the 1930s Depression in Australia was limited by our federal division of powers between State and federal governments.

In political science, the level of interest in institutions has, however, varied over time. Section one of this chapter briefly traces the intellectual journey from the ‘old’ to the ‘new’ institutionalism in political science. This is followed in section two by a closer look at so-called new institutionalism. This is done partly through distinguishing between various strands or versions of new institutionalist theory: particularly so-called rational choice institutionalism and historical institutionalism. In section three we briefly examine some theoretical applications of institutionalism in terms of how institutional factors have been used to build accounts of ‘policy networks’ and ‘state capacity’. Mention will also be made of how institutions shape ‘varieties of capitalism’ across countries and section three also briefly looks at how institutionalist theory has found practical applications in areas such as public sector and central banking reform. Finally, section four looks briefly at some of the frontiers of institutional analysis, especially at questions of institutional change.

The Road to New Institutionalism

In the late nineteenth and early twentieth centuries, political science did the obvious. It commenced by describing and mapping the formal institutions of government and the modern state, both within specific countries and on a comparative basis. In tandem with constitutional research by students of law and studies in public administration (a sub-field within political science), the emphasis in this kind of ‘old’ institutionalism in political science was on charting the formal-legal and administrative arrangements of government and the
public sector. From today’s perspective, the old institutionalism displayed little interest in cumulative theory building (Shepsle 1989: 132; Easton 1971: 77; Eckstein 1979). The main emphasis was on description, not on explanation or theory building. Studies were also often constructed on an evaluative framework which attempted to assess how well certain institutions measured up to democratic norms or the principals of responsible government (Rhodes 1995). Old institutionalism is not dead, however. Description of institutional arrangements is still an important aspect of research in politics and formal-legalism is still prominent in fields such as constitutional studies and public administration. When old institutionalists did turn to explanation it was assumed that political behaviour was more or less scripted by the *formal* rules or procedures of the institutional setting. On this front, there is some overlap between the old and the new institutionalism (Hirsch 1997).

In the post-World War II era, a second major school in political science developed (especially in the United States). This rejected or at least watered down the focus on institutions and argued instead that political behaviour and the sources of political power were derived primarily through *informal* relationships within and beyond the institutions of government. In particular, attention shifted somewhat away from the state and the formal organisations of government towards a more ‘society centred’ focus, with an emphasis on the socially embedded nature of pressure group politics, individual political behaviour and informal distributions of power. It was argued that the best way of explaining behaviour was not through reading the rule book but through the direct observation of behaviour itself: hence the term ‘behaviourism’ as the label for this school (Krasner 1984: 229; Rhodes 1995: 48-50). Not surprisingly, the institutional landscape tended to recede under this style of political analysis. In this regard, March and Olsen (1984: 735) highlight several central aspects of behaviourism. First, it was ‘reductionist’. Explanations of political phenomena were reducible to the aggregate consequences of the behaviour of atomistic *individuals* and hence behaviourism was less inclined to ‘ascribe the outcomes of politics to organisational structures and rules of appropriate behaviour’. As Shepsle (1989: 133) argues, institutions were assumed to be ‘empty shells to be filled by individual roles, statuses and values.’ Second, March and Olsen argue behaviourism was ‘utilitarian’ in that action was seen ‘as the product of calculated self-interest’ rather than the product of actors ‘responding to obligations and duties’.

New institutionalism amounts to ‘bringing institutions back in’ and a revival and expansion of this approach that has been underway since the 1980s. In political science, there have been a number of reasons for the renewal of interest in institutions. First, ‘social, political and economic institutions have become larger, considerably more complex and resourceful, and *prima facie* more important to collective life’ (March and Olsen 1984: 734). Second, there has been a renewed interest in the ‘state’ in a number of schools of political analysis, including Marxism and so-called ‘statism’ (Krasner 1984; Skocpol 1985; Bell 1997). Third, institutional factors have figured prominently in explanations of why countries pursued such different responses to the common economic challenges of the 1970s and 1980s (especially the oil crisis and rising inflation and unemployment)(Thelen and Steinmo 1992: 5). Fourth, the major public policy revisions since the 1970s in the face of such challenges have also involved wholesale institutional restructuring, impacting especially on the role of the state and involving substantial public sector reform.
New Institutionalism

So pervasive has the impact of institutionalism been that each of the social science disciplines now has its own ‘new institutionalism’ (Lowndes 1996; Koelble 1995). In economics, there have been a range of arguments about how and why institutions matter (Hodgson 1988). For example, scholars have argued that institutions can play an important role in reducing transaction costs and various associated forms of market uncertainty and information costs and also in helping to monitor and enforce contracts and agreements. Thus, economic institutions, such as the firm, are created to organise a process of pulling back from the open market to ‘internalise’ certain forms of transactions to help cope with such problems (North 1990, Williams 1985, Zald 1989). In sociology, emphasis is put on the way in which institutional life establishes normative orientations, conventions and taken-for-granted practices that shape and influence behaviour, often in subtle ways (DiMaggio and Powell 1991). And in political science, as we saw above, there has been renewed interest in how institutional arrangements shape the behaviour, power and preferences of actors in politics.

All strands of new institutionalism share a common critique of atomistic accounts of social processes (Lowndes 1996; Shepsle 1989: 134). In political science, the critical difference between behaviourism and new institutionalism is that the focus on atomistic actors in the former is replaced (or at least modified) by a focus on institutionally ‘situated’ actors in the latter. Institutions, according to Shepsle (1989: 134), ‘are the social glue missing form the behaviourist’s more atomistic account’, whilst Krasner (1984: 228) writes that:

The political universe is not atomistic. Atoms are bound together in stable molecules and compounds. The preferences of public officials are constrained by the administrative apparatus, legal order and enduring beliefs.

It should also be added that institutions provide actors with opportunities as well as constraints. At bottom, however, and as argued above, institutions are important in providing actors with sets of behavioural incentives and disincentives, with sets of normative and ideational codes which shape not only behaviour but also preferences, and with resources, including power resources.

In political science two different schools of new institutionalist analysis have emerged. One is called the rational choice approach, the other is termed historical institutionalism.

Rational Choice

The rational choice approach borrows heavily from economics and adopts a ‘deductive’ methodology. This means that explanations and working hypotheses are ‘deduced’ from abstracted first principle assumptions about the motives and behaviour of actors. The rational choice approach, as the name implies, assume that actors are rational. Shepsle (1989: 1340 defines a ‘rational agent’ as one:

Who comes to a social situation with preferences over possible social states, beliefs about the world…and a capacity to employ these data intelligently. Agent
behaviour takes the form of choices based on either intelligent calculation or internalised rules that reflect optimal adaptation to experience.

Actors are also assumed to be selfish, utility maximising individuals. Hence, their primary motives are assumed to be self-interested. What about preferences? These are assumed to be shaped or determined by the institutional context in which selfish motives are pursued. In this manner, hypothetical individuals are placed in an institutional context – a sort of behavioural box - which is essentially understood as a structured field of behavioural incentives and disincentives as derived from the formal and informal rules and practices of the institutional setting.

The emphasis on rational calculation in this approach highlights the view that institutions are not only an important cause of behaviour but are also an effect of behaviour. Rational choice writers argue that institutions are constructed by individual actors for rational purposes and that individual actors engage in changing and shaping institutional environments to suit their goals. In contrast, historical institutionalists tend to emphasise the ‘embeddedness’ of institutions and question the rationalist’s assumption that meaningful conceptions of rationality can be developed a priori, or prior to the analysis of particular forms of rationality and behaviour in particular institutional settings. As Koeble (1995: 235) puts it: ‘Individuals are viewed as “embedded” in so many social, economic and political relationships beyond their control and even cognition that it is almost absurd to speak of utility-maximising and rational behaviour in a strictly economic sense. The very concept of rationality is dependent upon its environment’. For these reasons, historical institutionalists highlight what they see as the historical and evolutionary nature of institutional design and change and tend, more so than rational choice writers, to emphasise institutions as shapers of rather than the rational product of individual behaviour.

A much debated aspect of rational choice institutionalism and a key point of contention for critics of the approach is the use of this deductive methodology and the tendency towards relatively narrow, even mechanical specification of actor motives, preferences and institutional contexts. Critics have questioned the assumption that actors are always driven by motives featuring self interested maximising strategies (Self 1993). Even more contentious has been the way in which actor preferences, or how the content of the maximising motive, is specified. Hall and Taylor (1996: 951), for example, depict the rational choice approach as one which tends to make universal assumptions about actors and which ‘specifies the preferences or goals of the actors exogenously to the analysis’. Yet to obliterate the specific context in framing assumptions about actor goals and preferences seems an unhelpful way to proceed and the more nuanced formulation by Thelen and Steinmo (1992: 8) is surely a better approach. As they argue:

Rational choice institutionalists in effect ‘bracket’ the issue of preference formation theoretically (by assuming that political actors are rational and will act to maximise their self-interest), though of course in the context of specific analyses they must operationalise self-interest, and they generally do so by deducing the preferences of the actors from the structure of the situation (my emphasis).
Hence, the behaviour of politicians, for example, is modelled as largely determined by an assumed preference imperative derived from their institutional context: essentially the maximisation of votes; much as Jim Hacker behaves in *Yes Minister* (Borins 1988). The behaviour of bureaucrats (*a la* Sir Humphrey Appelby) is modelled as the quest for bureaucratic resources and power and favoured institutional roles (Dunleavy 1991).

The problem of course is that we know that politicians and bureaucrats do not always behave like this (Self 1993). For example, I have argued elsewhere that the rational choice approach provides a poor empirical account of the recent behaviour of politicians and central bankers in Australian monetary policy (centring on the Reserve Bank’s role in setting interest rates) mainly because the approach frames actor preferences too narrowly and tries to model complex interactions using, as Hall and Taylor (1996: 950) put it, overly ‘simplistic’ behavioural assumptions (Bell 2000). There is an old debate in the social sciences about the extent to which agents’ behaviour is self determined or whether or to what extent their behaviour is shaped by wider institutions or structures – the so-called agency/structure debate. A common critique of rational choice approach is that it overemphasises institutions and structures and down plays choice and agency, ending up with a fairly mechanistic form of explanation. As Hay and Wincott (1998: 952) explain:

> Despite its putative concern with individual choice, rational choice theory strips away all distinctive features of individuality, replacing political subjects with calculating automatons. Rather than accounting for the choices of a situated subject, it describes what any utility maximising chooser would do in a given situation. In this way, rational choice analysis moves from an apparently agent-centred individualism exhibited in choice, to a deep structuralism, simply [and too mechanically] deriving action from context.

Historical (and Sociological) Institutionalism

Are there better ways of accounting for the ‘choices of situated subjects’? The most basic claim of all types of institutionalism is that institutions matter when it comes to explaining political behaviour. But an important question is how much do they matter? We have just argued that the rational choice approach has lent too far towards a relatively rigid form of institutional ‘over determination’. Does historical institutionalism get around this problem?

In contrast to the rational choice approach, the historical institutionalist methodology is inductive, not deductive (Thelen and Steinmo 1992: 10; Hay and Wincott 1997: 955). Thus, the search for empirical regularities through repeated observations, not deductive first principles, is the preferred strategy for inquiry. Also, whilst historical institutionalists emphasise the shaping role of institutions, there is less emphasis than in the rational choice approach on hard and fast rules or tight institutional constraints. Moreover, unlike the rational choice approach where the key question for actors is ‘how do I maximise my utility in this situation’, the key question from an historical institutionalist perspective is, ‘what is the appropriate response to this
situation given my position and responsibilities?’ (Koeble 1995: 233). March and Olsen (1989: 22) refer to this latter perspective as the ‘logic of appropriateness’ in institutional life. Again, compared to the tightly defined, pre-packed sets of motives and goals typically found in rational choice deduction, the process of working out and defining the meaning of appropriate action or ‘responsibilities’ is more open-ended. The critical point from the historical institutionalist perspective is that despite operating under conditions of constraint, actors are also interpretive and choice making subjects. Moreover, as sociological institutionalism, a third strand of institutionalist theory, points out, actors react not just to the hard wiring of their institutional environment but shape their interactions with institutions and with others through frames of reference, moral templates and normative orientations (DiMaggio and Powell 1991; Hall and Taylor 1996). These may be institutionally defined or imported from elsewhere, and as just suggested, they are not necessarily slavishly followed but actively interpreted: institutional and ideational environments interact (Scharpf 1997: 36).

The argument here, then, is that historical institutionalism (in tandem sociological institutionalism) is helpful in explaining the choices of situated subjects in institutional settings. Historical institutionalism’s strength is its inductive methodology and its willingness to derive working models of rationality and actor preferences not through abstracted assumptions but through careful empirical observation. Taking actor preferences and rationality seriously is an important step in building a proper ‘micro foundational’ account of politics and institutional life. For this reason there is no need, as Kato (1996) rightly argues, to use the rationality assumption to distinguish between various strands of institutionalism. Instead the real issue is how to deal with and utilise the rationality assumption. As Katznelson (1998: 197) argues, the most appropriate methodology is to search for:

situated understandings of rationality…[which] emphasise that rationality [and preferences] can only be inferred over time; that particular versions make sense only in specific normative and institutional settings which are culturally and structurally thick, not just strategically lean.

In other words, historical institutionalists agree with rational choice scholars that actors operate in a strategic manner (Zysman 1994: 277; Thelen 1999: 380). But we need to know more than this. We need to able to specify the content of such strategic behaviour and understand, through historically based empirical analysis, why certain goals or ends are emphasised over others.

Applications

Institutionalism has a wide range of applications in political analysis and public policy. In this section we briefly review how institutional analysis has been applied to studies of policy networks and state capacity. Mention is also made of the institutional foundations of ‘varieties of capitalism’ and we also look briefly at some of the practical public policy applications of institutionalism.

First, policy networks. A policy network can be defined as a structured pattern of interaction between the key actors in a given public policy arena, be it health policy, economic policy or whatever. Typically, the key actors in question are state actors (politicians, key bureaucrats) and non-state actors (business leaders,
unionists, interest group leaders etc.) who bargain and wield power and resources in patterns of policy contest and compromise. As such, a policy network - as a structured pattern of interaction between policy actors - is not an institution but a set of behaviours between actors. For our purposes, the critical thing about a policy network is that such interactions and behaviour are strongly influenced by institutional factors. These factors typically involve the nature of the state in a given policy arena and the institutional and organisational capacities of the major non-state actors or organisations in question. For example, in Australia – mainly because of our liberal political traditions - most policy arenas are characterised by ‘pressure pluralist’ policy networks. The institutional factors which typically underpin such a pattern of interaction include:

- A state which is fragmented, which is open and porous to external demands and pressures (i.e. strongly liberal democratic), and which has only a limited capacity for centralised coordination.
- A non-state sector which is fragmented with multiple groups and associations displaying relatively weak internal leadership and organisational capacities.

In such a network policy is typically made through a struggle of competing interests with little capacity for leadership or strategic direction. The type of policy making which typically emerges from such a network tends to be ad hoc and reactive. The state itself is too weak and open to impose order much from above and the non-state actors are themselves fragmented and unable to exercise decisive leadership. The system may be quite democratic in the sense that there are many voices, but it is also often directionless and frustrating from any kind of strategic policy perspective. Hence, whatever their strategic or normative preferences, if actors find themselves in an institutionally embedded pressure pluralist policy network, a policy muddle of many voices, limited leadership and slow policy change is likely to be the result (see Atkinson and Coleman 1989; Bell 1992).

A good example of a pressure pluralist policy arena in Australia is in the area of rural land and water use and the problems of salination and land degradation. Here a multiple array of often competing rural sectors and their associations interact with a fragmented state structure comprised of various statutory bodies and State and federal governments in a classic pressure pluralist, almost ‘gridlocked’ policy network featuring slow and torturous steps towards policy adjustment or reform. The Australian political system tends to produce pressure pluralist policy networks in a wide range of policy arenas, though there have been exceptions. A good example was the ‘corporatist’ policy network known as the (1983-96) Accord. This was a national wage bargaining system involving a coherent state entity (the ALP federal government) bargaining directly with the Australian Council of Trade Unions (ACTU); a peak association that was able to effectively represent, lead and discipline the Australian trade union movement. This policy network was relatively strategic in the sense that it was focussed on achieving longer-term goals and involved effective coordination between the main state and non-state actors.

Second, state capacity. The concept of state capacity simply refers to the ability of a state to achieve its own goals. Institutional factors play a major role in defining and underpinning state capacity. The particular types of institutional capacities in question overlap to some extent with the policy network dynamics noted above, particularly in relation to the institutional attributes of the state. The literature on state capacity is
broad ranging, but researchers have focussed on a number of critical institutional foundations of state capacity (see Evans 1995, Weiss 1998). First, the degree of state autonomy and authority is said to matter. State autonomy implies a degree of insulation from societal pressures and political opponents which in turn implies that such states have the capacity to push through policy reforms, despite opposition. State authority implies that such autonomy has a degree of popular acceptance and legitimacy. Hence, relatively autonomous and authoritative states have the capacity to push beyond the type of pressure pluralist political gridlock noted above and get things done. State capacity is also said to be enhanced by having a relatively hierarchical and centralised bureaucratic structure that is able to provide policy makers with the institutional means for purposeful and coordinated action. State capacity is also assisted by having a capable bureaucracy staffed with expert and dedicated policy advisers and policy implementors. Adequate resources (especially taxation revenue, cf. the state’s ‘extractive’ capacity vis-à-vis society) as well as appropriate policy instruments and related institutional resources are also critical. As Krasner (1984: 228) explains:

The ability of a political leader to carry out a policy is critically determined by the authoritative institutional resources and arrangements existing within a given political system. Industrial policy can be orchestrated in Japan though the Ministry of International Trade and Industry. There is no American institutional structure that would allow a political leader, regardless of the resources commanded, to implement a similar set of policies.1

Beyond this, the ability of state leaders and policy makers to understand the needs of and to forge positive, collaborative and change-oriented relations with key groups or sectors (‘state embeddedness’) is also thought to be an important institutional relationship supporting state capacity. This capacity for positive state-society collaboration, or what Weiss (1998) terms ‘governed interdependence’, in turn depends on the organisational and associative capacity and outlook of major social or economic groupings and interest associations. Primarily, then, the relevance of the state capacity concept is that it underlines the fact that the resources and capacities of political leaders will be heavily shaped by the particular types of institutional environments in which they operate.

Institutions also underpin the varieties of capitalism we encounter in different countries. Japanese capitalism is not the same as capitalism in the United States, or in continental Europe. Innumerable studies in comparative political economy in recent decades have explored the key institutional variations across capitalist countries in terms of factors such as: patterns of corporate governance, relations between industry and the financial sectors, the nature of labour-management relations and the role of the state in the economy. These studies have also shown that, primarily because of these institutional differences, capitalist economies vary quite markedly in terms of their capacity for growth and innovation and in terms of how well they distribute the gains of economic growth, especially as reflected in comparative levels of unemployment and inequality (Hall and Soskice 2000; Berger and Dore 1996).

1 For a detailed argument about the limited capacities of the Australian state to mount an effective industrial policy see Bell (1993).
Finally, on the question of practical policy applications, institutionalist theory, particularly rational choice institutionalism, has had very significant impacts on recent major reforms in public sector management and institutional design. The typical starting point in such exercises is to assume the worst about human behaviour and build management and institutional systems with built in disincentives regarding such behaviour. As noted above, rational choice approaches assume rational but wholly selfish behaviour on the part of actors. Hence, the critical test in the institutional design of public or governing institutions, according to Brennan and Buchanan (1981: 161) is ‘whether institutions serve to help transform private interests into public interests’. Several examples will illustrate this.

First, one of the guiding aims of the so-called new public management reforms that have swept various countries (including Australia) since the 1980s has been to exert more ministerial control over the bureaucracy in order to limit assumed self-serving behaviour, particularly of senior bureaucrats. The theoretical inspiration for this has partly come from rational choice theory and also from so-called principal agent theory. The latter asks, how can ministers (the principals) better control their agents (the bureaucrats)? The answer has been to use a device drawn from the realm of the market; contracts. Hence the management reforms have aimed to abolish the security of tenure of senior bureaucrats and place them on short-term contracts involving strict provisions regarding goals and performance standards.

Second, across the world in the 1990s (including Australia) rational choice institutionalism has guided quite drastic reforms to the operations of central banks (Bell 2000). Central banks now control the key instrument of monetary policy; the setting of official interest rates. Rational choice theory argues that politicians have institutional incentives to ‘interfere’ with monetary policy, primarily in the quest for votes (eg lowering interest rates prior to an election). Central bankers are assumed to have strong incentives not to recklessly fiddle with monetary policy (eg. they are assumed to be ‘sober’ guardians of money, they are said to worry more about negative financial market reactions etc). Whatever, the validity of these assumptions, the idea that authority over monetary policy should be transferred from politicians to central bankers has caught on. Hence, in this case, institutional position is assumed to shape incentives and behaviour and the institutional design or fix for the assumed errant behaviour of politicians has been to remove monetary policy from direct democratic control and place it with ‘independent’ central banks (Kirchner 1997). Similar, proposals have recently been made with respect to the adjustment of tax rates and aspects of fiscal policy (Business Council of Australia 1998).

Frontiers of Institutionalism

There are several key issues that stand at the current frontiers of institutionalist research. First, there is the question of the relationship between institutions and political power. The main issue here is to work out the extent to which power dynamics need to be understood (1) as an artefact of specific institutional arrangements and (2) as an artefact of the structural location in which particular institutions exist. Second, scholars have tried to explore the nature of the relationship
between institutions and world of ideas, language and discourse (Campbell 1997; Thelen and Steinmo 1992: 16-22). Third, there is the issue of institutional change and how to explain it; an issue taken up briefly here.

One debate in relation to institutional change concerns the nature and particularly the speed of change. Some, such as Krasner (1984), emphasise the 'stickiness' and slowness of institutional change. Institutional life tends to emphasise the role of established rules, routines, taken-for-granted practices, policy legacies, sunk costs and path dependency. Hence, as Thelen and Steinmo (1992: 16) argue, a ‘critical inadequacy of institutionalist analysis has been a tendency towards mechanical, static accounts that largely bracket the issue of change and sometimes lapse inadvertently into institutional determinism’. In this view, institutions are seen as strong on inertia, resisting change until perhaps mounting pressures suddenly force change with a lurch. Krasner (1984) refers to this kind of process as one of ‘punctuated equilibrium’; a notion which implies that the ‘normal’ pattern of institutional equilibrium or stasis is ‘punctuated’ by pressures for change. Others, broadly agree with this perspective but argue that change can also build up through smaller incremental steps (Cortell and Petersen 1999).

A related issue is how to explain change. Institutionalism would seem better at explaining institutional inertia not episodes of change, especially rapid change. Therefore, cases featuring rapid and dynamic change might be expected to push at or indeed beyond the limits of institutionalist explanation. Nevertheless, it is always important to explain change processes as an interaction between institutional actors and external pressures. However, most of the models of institutional change emphasise that the key drivers of change are often external or exogenous to the institutional setting, usually the result of some kind or external disturbance or crisis. In this respect, Thelen and Steinmo (1992: 16) present three models of institutional change and dynamism, all of which emphasise exogenous causation. First, ‘broad changes in the socioeconomic or political context can produce a situation in which previously latent institutions suddenly become salient’; second, similar drivers of change ‘produce a situation in which old institutions are put in the service of different ends’, and third, where ‘exogenous changes produce a shift in the goals or strategies being pursued within existing institutions’. Examples of such models are not hard to find. For example, they reflect what has happened to the Reserve Bank of Australia over the last twenty years. External contextual changes (financial deregulation, high inflation in the 1970s and 1980s, and a change in monetary policy Instruments) have helped transform the institution in the ways described by Thelen and Steinmo. But are such exogenous accounts of change enough? Probably not. Take the case of the Tariff Board In the 1960s. This was a federal government body charged with setting tariff levels which (1) drastically changed its role (in the direction of pushing for lower tariffs) without altering its institutional parameters and (2) was a case in which inspired leadership from within forced a rapid
change process. Still, as Pontussen (1995) argues, we should never look at institutions in isolation from their environment. In the tariff Board case, changes in Australia's place in the international economy played an important role in setting up favourable conditions which assisted the Tariff Board's leadership to drive the change process (Bell 1993: ch 3).

Conclusion

This chapter has argued that institutions matter in political life and it has tried to explain how and why this is so. Institutions can be defined as sets of rules, codes or tacit understandings which shape behaviour. Whether they determine behaviour is another matter. As we saw above, rational choice approaches to institutionalist explanation run perilously close to this. For this reason it is best instead to carefully explore the interaction between institutions and the ‘situated subjects’ within them. The emphasis should be on actors as the primary unit of analysis and how they interpret and make choices within their institutional environment. It is these interpretive processes which have been the focus of the research mentioned above on how ideas and discourse interact with institutional settings.

Reference was made above to the fact that the old institutionalism was somewhat theoretically anaemic. This cannot be said of new institutionalism. Instead of description or normative evaluation, the focus of new institutionalism is more oriented towards explanation and explicit theory building. The approach forces us to reconsider central theoretical issues, such as the agency/structure debate. There is also the related issue of how institutions interact with wider structural forces in politics and the economy, and, as just noted, explorations of the links between the institutional and ideational realms are underway. These linkages underline the fact that institutional accounts of politics, whilst often being of critical importance, can only ever be one (middle range) dimension of more fully rounded explanatory accounts in political analysis.

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