

Norman Schofield · Gonzalo Caballero · Daniel Kselman *Editors*

Advances in Political Economy

Institutions, Modelling and Empirical Analysis

This book presents latest research in the field of Political Economy, dealing with the integration of economics and politics and the way institutions affect social decisions. The focus is on innovative topics such as an institutional analysis based on case studies; the influence of activists on political decisions; new techniques for analyzing elections, involving game theory and empirical methods.

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- 185 (a) The original institutionalism in economics (Thorstein Veblen, John Commons,
186 Clarence Ayres) rejected the foundations of neoclassical analysis and adopted
187 the methods of holism analysis. The contributions of such old institutionalists
188 was marked by an anti-formalist nature, a tendency to argue in holistic terms
189 and a “collectivist and behavioristic framework”, as well as their rejection to
190 the individualist welfare criterion and their tendency towards a certain economic
191 interventionism (Rutherford 1994). It was centered on distributive consequences
192 of the many institutional structures and devised its theories and analysis based
193 on the conceptualization of power.
- 194 (b) The old institutionalism tradition in political science was made up of a set of
195 multi-approach heterogeneous contributions and assumed certain general char-
196 acteristics such as legalism, structuralism, holism, historicism and normative
197 analysis (Peters 1999).
- 198 (c) The earlier sociological institutionalism pioneered by Talcott Parsons (1937) as-
199 sumed the existence of institutions, but it did not emphasize institutional analy-
200 sis. Just as Nee (1998, p. 5) points out the tradition of comparative institutional
201 analysis established in the classical and modern periods of sociology, provides
202 an appropriate foundation for the new institutional approach in sociology, where
203 Weber (1922—*Economy and Society*) is probably the best example of the tradi-
204 tional sociological approach to comparative institutional analysis.

205 On the other hand, New Institutionalism in the social sciences assumes the
206 choice-theoretic tradition and generally presumes purposive action on the part of
207 individuals, who act with incomplete information, inaccurate mental models and
208 costly transactions (Nee 1998). It tends to move towards methodological individu-
209 alism, the conceptualization of voluntary exchange and the study of the effects of
210 alternative institutional frameworks on efficiency. In this manner, “new institutional-
211 ism” appears to be more formalistic, individualistic and reductionist, it is orientated
212 to rational choice and “economizing models”, and it shows a less-interventionist
213 character (Rutherford 1994).

214 In economics, Coase (1984) sustained that “if modern institutionalists had any
215 antecedent, then we should not be looking for these in their immediate predeces-
216 sors”. NIE therefore did not arise from the old institutionalism but was created
217 thanks to a set of contributions that highlighted the relevance of institutional and
218 organizational aspects, and these contributions arose from different scientific ar-
219 eas such as Property Rights Analysis, the New Economic History, the New Indus-
220 trial Organization, Transaction Cost Economics, Comparative Economic Systems,
221 and Law and Economics (Eggertsson 1990). The analytical framework of the NIE
222 is a modification of neoclassical theory, and it preserves the basic assumptions of
223 scarcity and competence, as well as the analytical tools of microeconomic theory,
224 however, it modifies the assumption of rationality and further adds a time dimension
225 (North 1994).

226 Nevertheless, the idea of a serious rift between the old and new institutionalist
227 economists has been modified in recent times. For example, North (1994, 2005),
228 Greif (2006) and Ostrom (2007) surpassed the limits of the methodological indi-
229 vidualism and the hypothesis of rationality, going beyond the bounded rationality.
230

In this sense, Groenewegen et al. (1995) found some bridges between new and old institutionalism via the North's contributions, and Hodgson (1998) pointed out the evolution of the new institutionalist project towards a possible convergence with the thinking of the old economic institutionalism. In spite of the considerable concern among new economic institutionalists to differentiate themselves sharply from the old American institutionalism, some aspects of the new institutionalism are connecting back to the old institutionalism in recent years (Rutherford 2001).

Simultaneously with the consolidation of the New Institutional Economics, Hall and Taylor (1996) stated that during the eighties and nineties of the 20th century, there existed three approaches in political science and sociology, each of which called itself a "new institutionalism" as a reaction to the behavioral perspectives, these being:

- (1) Historical Institutionalism developed in response to the group theories of polities and structural functionalism, and it defines institutions as formal and informal procedures, routines, norms and conventions embedded in the organizational structure of the polity. This approach emphasizes the relevance of early decisions throughout political history: the initial political decisions determine the course of politics and consequently of any posterior political decision (Thelen and Steinmo 1992; Thelen 1999; Pierson 2000; Pierson and Skocpol 2002). This implies that there exists a "path dependence" which generates an institutional inertia, which results in the persistence of initial decisions made by government. Historical institutionalism, whose term was coined by Theda Skocpol, has Peter Hall (1986) as one of its principal precursors, however it was Steinmo, Thelen and Pierson who provided some of the main contributions to this approach.
- (2) Rational choice institutionalism (RCI) arose from the study of the American congressional behavior and it received some inputs from the "new economics of organization". This approach perceives institutions as a system of rules and incentives for behavior within which individuals try to maximize their benefit and therefore RCI sustains that behavior is a function of rules and incentives. Four of its features are as follows: (A) It employs a model of rationality when it tries to explain human behavior. (B) It tends to see politics as a series of collective action dilemmas. (C) It emphasizes the role of strategic interaction in the determination of political outcomes. (D) With respect to the origin of institutions, RCI explains the existence of the institution by reference to the value provided by those functions to the actors affected by the institutions.
- (3) Sociological institutionalism has been developed in sociology, especially in organization theory. It considered that many of the institutional forms and procedures were not adopted to gain efficiency, but instead should be considered as culturally-specific-practices. This type of institutionalism, to which Hall and Taylor (1996) incorporate the contribution of March and Olsen (1984), can be characterized in the following manner: (A) Sociological institutionalists define institutions much more broadly than political scientists do, and their definition includes a set of elements such as symbol systems, cognitive scripts and moral templates. (B) It emphasizes the highly-interactive and mutually-constitutive

277 nature of the relationship between institutions and individual actions. (C) In as
278 far as the origin and change of institutions is concerned, institutions can adopt
279 a new institutionalist practice because it enhances the social legitimacy of the
280 organization and its participants.

281 A more complete map of new institutionalism in social sciences has been pre-
282 sented using eight approaches (Peters 1999): Normative Institutionalism, Ratio-
283 nal Choice Institutionalism, Historical Institutionalism, Empirical Institutionalism,
284 New Institutional Economics, Sociological Institutionalism, Interest Representation
285 Institutionalism and International Institutionalism. Although some of the classifica-
286 tion criteria are not clear and could be discussed or adapted, this extended map
287 is quite useful for understanding the diversity, pluralism and complexity of the new
288 institutionalism in social sciences.

289 In that map, the sociological institutionalism indicated by Hall and Taylor (1996)
290 is divided into two approaches namely, a normative institutionalism and a truly soci-
291 ological institutionalism. (A) Normative institutionalism highlights the central role
292 assigned to norms and values within organizations for understanding how institu-
293 tions function and their influence on the behavior of individuals (March and Olsen
294 1984, 1989). Institutions mold their own participants and supply meaning systems
295 for those participating in politics, and therefore this approach renounces the exo-
296 geneity of preferences. (B) There has been a strong institutional analysis tradition
297 in sociological research right from the time of classical authors such as Weber or
298 Durkheim. Such tradition has been maintained in areas like historical sociology and
299 organizational sociology and we can distinguish between an old and a new insti-
300 tutional school of thought in sociology, based on the irrational sources of institu-
301 tions, the conception of relations between the institution and its environment and
302 the molding role of politics. The new approach in sociology should be construed as
303 an individualization process of societies.

304 Moreover, another approach, empirical institutionalism in politics, has been
305 added in the map due to its lack of theoretical approach and because it emphasizes
306 a set of traditional empirical institutional issues. This approach empirically studies
307 certain institutional differences and their effects, and furthermore indicates that gov-
308 ernment structure conditions the politics and decisions of governments. Empirical
309 institutionalism has been centered on the study of a group of applied issues, such
310 as the differences between presidential and parliamentary government, the case of
311 the “divided government”, the legislative institutionalization or the independence
312 of central banks. Some of these contributions are descriptive and nearer to the old
313 traditionalist approach (for examples, the contributions of Woodrow Wilson), but
314 others imply a more advanced empirical analysis (Peters 1999).

315 Finally, pointing out the aim of the study, two other institutionalist approaches
316 have been incorporated in the map. On the one hand, Interest Representation Insti-
317 tutionalism analyzes the structure of such “institutionalized relationships” between
318 State and society, assuming that there are many relations in politics that are con-
319 ceptualized as being less formal and highly institutionalized, such as Kickert et al.
320 (1997) show. The interest representation institutionalism is especially centered on
321 the analysis of the actions of political parties and interest groups. On the other hand,
322

323 the approach of International Institutionalism conceives international politics along
324 institutional lines and highlights the role of structure when explaining the behavior
325 of States. International institutionalism perceives regimes as international level
326 institutions, since they generate stability and predictability, shape the behavior of
327 States and promote a set of values. One of the relevant research lines in international
328 institutionalism has been led by Keohane and Nye (1977).

329 In this sense, the views of Hall and Taylor (1996) and Peters (1999) on institutionalism
330 are different but compatible, and we should complete the overview with
331 the incorporation of the NIE. In order to integrate TCP within the new institutionalism,
332 we need to first perform a detailed analysis of RCI and the NIE.

335 **3 Rational Choice-Institutionalism and New Institutional** 336 **Economics**

338 **3.1 Rational Choice Institutionalism**

339
340 The program of Public Choice was the principal development of rational choice for
341 studying politics after the Second World War. Sometime later, academic tradition of
342 rational choice gave rise to a set of tasks that assumed the importance of institutions
343 in political life and included political institutions into the research agenda of rational
344 choice theory. We can therefore use the concept of RCI (Shepsle 1986, 2006; Hall
345 and Taylor 1996; Weingast 1996, 2002; Peters 1999).

346 RCI emerged from the rational choice approaches that assumed methodological
347 individualism, and it inherits the importance of basing political activity on human
348 behavior theories that explain the nature of individuals. As against other approaches,
349 such as normative institutionalism, which do not provide a specific theory for human
350 behavior, rational-choice is characterized for presenting a clear and explicit model
351 of individual behavior. However, even though Rational Choice did not attend to
352 institutions in a relevant manner during its early stages, it did end up generating
353 theoretical developments which incorporated the role of political institutions. In this
354 sense, some authors have used the expression “actor-centered institutionalism” to
355 indicate the important role bestowed to individuals by the RCI (Peters 1999).

356 Rational choice theory has provided a distinctive set of approaches to the study
357 of institutions, institutional choice and long-term durability of institutions (Weingast
358 1996, p. 167). This approach provides a systematic treatment of institutions
359 through the importation of the micro-foundations of institutional analysis from rational
360 choice theory. Institutions are conceived as a set of rules and incentives that
361 restrict the choice possibilities of political agents, who seek to maximize their preferences
362 within such an institutional framework. According to Kiser and Ostrom
363 (1982), institutions are rules that individuals use to determine what and who is included
364 in decision-making situations, how the information is structured, what measures
365 can be taken and in what sequence, and how individual actions are integrated
366 into collective decisions. In this manner, RCI sets out the role of institutions in political
367 activity as a means of containing the uncertainty of action and political results.

369 RCI considers political institutions as structures of voluntary cooperation that
370 resolve collective action problems and benefit all concerned. Therefore, the way
371 to resolve collective action problems through cooperation can be found in formal or
372 informal institutions, and this permits opportunistic individuals looking for personal
373 gains to obtain mutual benefits.

374 Individuals observe that institutional rules also limit the choice possibilities of
375 competitors, and realize that rules benefit the entire group of individuals. Shepsle
376 (1986) states that any cooperation that is too costly at the individual agent level is fa-
377 cilitated at the institutional level. In this manner, institutions appear as ex-ante agree-
378 ments to facilitate cooperation structures, as claimed by Weingast (2002), when he
379 affirms that we need institutions to obtain gains from cooperation.

380 RCI assumes the following three features: (1) Rational individuals that maximize
381 personal utility are the central actors in the political process. (2) RCI has been con-
382 cerned with the problem of stability of results and the problem of control of public
383 bureaucracy. (3) Institutions are formed on a tabula rasa (Peters 1999).

384 Weingast (1996) points out four characteristic features of RCI: (A) This approach
385 provides an explicit and systematic methodology for studying the effects of institu-
386 tions, which are modeled as constraints on action. (B) The methodology is explic-
387 itly comparative, through models that compare distinct institutional constraints with
388 their corresponding implications in behavior and outcomes and through the analysis
389 of how behavior and outcomes change as the underlying conditions change. More-
390 over, this approach affords comparisons of the behavior and outcomes under related
391 institutions within a given country and of the effects of similar institutions across
392 countries. (C) The study of endogenous institutions yields a distinctive theory about
393 their stability, form and survival. (D) The approach provides the micro-foundations
394 for macro-political phenomena such as revolutions and critical election.

395 Two separate levels of analysis can be distinguished in the RCI (Shepsle 1986,
396 2006; Weingast 1996), namely; (a) A level considers institutions as fixed and exoge-
397 nous, i.e., analyzes that study the effects of institutions; (b) the other level studies
398 institutions as endogenous variables, that is to say, why institutions take particular
399 forms (Weingast 1996).

400 In as far as Weingast's (1996) first level of analysis is concerned, we have to point
401 out that work has been done on almost all democratic institutions such as constitu-
402 tions, the legislative body, the executive body, bureaucracy, the courts of justice and
403 the elections. The analysis is centered on how institutions influence results and we
404 can verify that micro level details have a great influence on results.

405 With respect to Weingast's (1996) second level of analysis, it covers questions
406 such as why institutions take one form instead of another, and why institutions are
407 altered in some circumstances but not others. The rules of the game are provided by
408 the players themselves; and these tend to be simple rules. Institutional arrangements
409 are focal and may induce coordination around them (Shepsle 2006). A model of
410 institutional stability must allow institutions to be altered by specific actors and it
411 must show why these actors have no incentives to do so (self-enforcing institutions)
(Weingast 1996).

412 Institutionalists of rational choice highlight the role of institutions in strategic
413 interaction between actors and in determination of political results (Hall and Taylor
414

1996). However, this institutionalism does not explain the details of how institutions are created, although it recognizes the possibility that the creation of institutions is a rational action of actors who are interested in the creation of those institutions. This approach, in any case, has a functionalist content (Peters 1999) and concludes a sense of “goodness” of institutions (Moe 2005).

3.2 *New Institutional Economics*

Price theory enables us to respond to some economic matters but not to others that require a richer theoretical body. NIE does not try to replace price theory but tries to “put it in a setting that will make it vastly more fruitful” (Coase 1999b), which implies the incorporation of institutional issues. As indicated by Arrow (1987), the NIE movement consists of answering new questions that traditionally were not framed in economic mainstream.

NIE accepts orthodox neoclassical assumptions of scarcity and competition, but it rejects the neoclassical assumption of perfect information and instrumental rationality, and it considers a theoretical framework with incomplete property rights, positive transaction costs and institutions, and assumes a world where the passage of time matters (North 1994).

The theoretical framework of the New Institutional Economics combines the *coasean* notion of transaction costs with the *northian* notion of institutions, such that institutions are a medium for reducing transaction costs and obtaining a greater efficiency in economic performance. On the one hand, Coase (1937) generated a microanalytical approach of organizations which gave rise to “transaction cost economics” (Williamson 1975, 1985, 1996); while on the other hand, Coase (1960) generated a macroanalytical approach that studied the relations between institutions and economic performance, as well as institutional change processes (North 1990a). NIE incorporates both approaches, which are mutually inter-related, that is to say, NIE studies institutions and how institutions interact with organizational arrangements within economy (Menard and Shirley 2005; Ostrom 1990, 2007).

Property rights are one’s ability to exercise choices over a good. Individuals will carry out transactions, i.e., they will carry out property rights transfers, which will produce transaction costs. We can define transactions costs as the resources used to maintain and transfer property rights (Allen 1991), that is to say, “transaction costs arise when individuals try to acquire new ownership rights, defend their assets against transgressions and theft, and project their resources against opportunistic behavior in exchange relationships” (Eggertsson 2005, p. 27). Transaction costs are the sum of costs required to perform the “transaction function”. The carrying out of transactions can be understood as a contracting problem, such that transaction costs are those which are derived from the signing *ex-ante* of a contract and of its *ex-post* control and compliance (Eggertsson 1990).

In a world with zero transaction costs, the parties concerned would carry out all the transactions that would result in social efficiency gains. However, as against this

461 hypothetical world where negotiation does not cost anything, economic markets
462 are characterized by the presence of positive transaction costs, and therefore no
463 transaction is carried out whenever such costs surpass the expected gains from such
464 transaction. The readjustment of rights will only go ahead whenever the value of
465 production from such transactions is greater than the costs implied in producing the
466 same (Coase 1960).

467 The level of transaction costs will depend on the characteristic traits of each spe-
468 cific transaction as well as on the nature of the institutional environment in which the
469 transaction is being carried out. In this sense, every society will have its own “rules
470 of the game”, which will determine the cost of carrying out transactions (North
471 1990a).

472 Understanding the relationship between institutions and economic performance
473 requires the study of human decision-making. NIE considers that the orthodox rati-
474 onality approach of human behavior is defective because: (a) individual motiva-
475 tions are not limited to maximizing wealth or utility: altruism and individual’s self
476 limitations also influence behavior; (b) individuals subjectively process incomplete
477 information of the world around them: there is need to distinguish between reality
478 and perception (North 1990a). NIE defends that individuals act with incomplete in-
479 formation and models that have been subjectively deduced, and assume the model of
480 bounded rationality, by conceiving the individual as intentionally rational but only
481 in a limited way (Williamson 2000).

482 Along these lines, North (1994, p. 362) states that “history demonstrates that
483 ideas, ideologies, myths, dogmas, and prejudices matter, and an understanding of the
484 way they evolve is necessary”. In order to understand the behavior of individuals in
485 decision-making within an uncertainty context, NIE considers the subjective mental
486 models of individuals as key factors. Such mental models will be closely linked
487 with institutions. “Mental models are the internal representations that individual
488 cognitive systems create to interpret the environment; institutions are the external
489 (to the mind) mechanisms individuals create to structure and order the environment”
490 (Denzau and North 1994, p. 4).

491 Together with the study of mental models and human behavior, NIE assumes the
492 importance of the passage of time to create institutions. Institutional change is char-
493 acterized by increasing returns and imperfect markets with high transaction costs.
494 In this theoretical framework, path dependence is reinforced by the externalities of
495 the institutional matrix, by the processes of social learning and by the creation of
496 the *shared mental models* on which individuals make decisions. Path dependence is
497 one way of bridging the choice gap and binding the evolution of a society over time
498 (North 1990a).

499 In this manner, the institutional framework not only determines the current eco-
500 nomic results but also delimits the set of opportunities that affect our future situation.
501 We can adopt an efficiency view when analyzing evolution of institutions, accord-
502 ing to which relative prices are the source of institutional change, however, NIE
503 sustains that the existence of transaction costs provokes the agents to not always
504 coincide towards the search for a greater efficiency.

505 The NIE argues that the processes of institutional change are normally incremen-
506 tal due to the increasing returns of institutional change: (A) Institutional change is

an incremental process that is heavily weighted in favor of policies that are broadly consistent with the basic institutional framework. (B) Institutional change is characterized by a slow evolution of formal and informal limitations. (C) Individual and specific changes in formal and informal institutions can change history but will find it difficult to reverse the course of history (North 1990a, 1990b).

Positive economic analysis conclusions cannot be exported from one economy to another in the case of economies with positive transaction costs, mental models and institutional changes: “you get a different answer for every country and every historical situation. . . there is no one way better economic system because everything depends on the society you are in” (Coase 1999a, p. 5).

The NIE is a research program that continually evolves, and recent new institutional contributions incorporate relevant advances and interesting questions on institutions. Eggertsson (2005) presents a general framework to reflect on institutional failure, social technology and institutional policy. North (2005) explores the relationships among cognitive science, institutions and economic change. Acemoglu and Johnson (2005) conclude that property rights institutions have a first-order effect on long-run economic growth and investment, while contracting institutions appear to matter for financial intermediation. Acemoglu and Robinson (2008) construct a model of simultaneous change and persistence in institutions where the main idea is that equilibrium economic institutions are a result of the exercise of *de jure* and *de facto* political power. Recently, North et al. (2009) propose the theoretical foundations for understanding violence and social order in human history.

4 Transaction Cost Politics

Transaction Cost Politics has emerged as an application of the theoretical approach of the New Institutional Economics to political analysis from a *madisonian* point of view in political economy (Shepsle 1999). Understanding the foundations of TCP implies a look to Rational-Choice Institutionalism and, especially, to the New Institutional Economics:

(A) Rational-Choice Institutionalism was interested in political markets and institutions, understood political institutions as a cooperation structure and assumed a model of rationality for political behavior. According to Rational-Choice Institutionalism, TCP focuses on political institutions, and indicates that “political institutions constitute *ex ante* co-operation agreements among politicians” (North 1990b, p. 359). Furthermore, TCP coincides with Rational-Choice Institutionalism when it defends the assumption of a rationality model for economic behavior, which implies a big difference from other institutionalists traditions such as normative institutionalism or the old approaches. However, the TCP rationality model is not found in Rational-Choice Institutionalism, and Rational-Choice Institutionalism forgot the main role of transaction costs and history, and therefore we should look to the NIE.

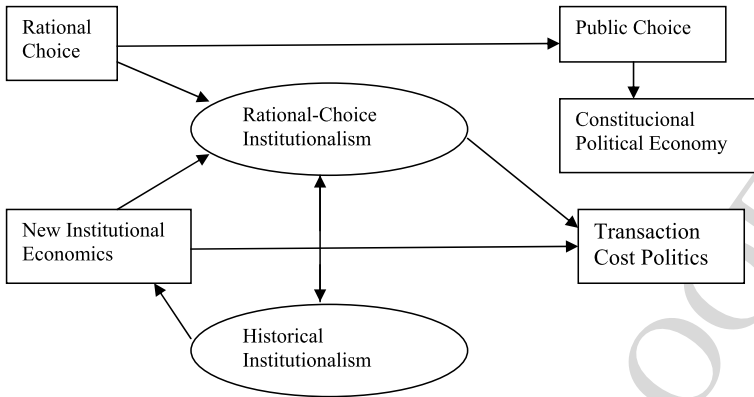


Fig. 1 Transaction Cost Politics

(B) NIE points out that the economic world is characterized by positive transaction costs and institutions. It rejects instrumental rationality by assuming the implications of bounded rationality and considers that the passage of time matters. TCP assumes these three NIE foundations when studying political transactions and institutions. “A transaction cost theory of politics is built on the assumptions of costly information, of subjective models on the part of the actors to explain their environment, and of imperfect enforcement of agreements” (North 1990b, p. 355). Moreover, TCP is interested in explaining the differential performance of polities over time, and therefore elaborates a theoretical framework where history matters.

TCP is different from RCI because TCP assumes three characteristic foundations of the NIE (bounded rationality, a transactional approach, passage of time matters). Figure 1 shows how the extension of Rational Choice theory towards political analysis allowed the emergence of Public Choice, with CPE as its main continuation, whereas the extension of the NIE towards political analysis allowed the appearance of TCP. In this sense, TCP—as an extension of the NIE—surpassed the theoretical framework of RCI in the same way that the NIE surpassed the (instrumental) rational choice approach. On the one hand, there is no direct relationship between CPE and TCP in Fig. 1 because their theoretical foundations have different origins, and on the other hand, historical institutionalism is shown as an antecedent of NIE and RCI but it has not a direct influence over TCP (the influence is indirect via NIE and RCI). Finally, we should point out that other institutionalisms, such as empirical, normative or sociological institutionalism, have not had influence on the emergence of TCP, and their references have not been incorporated in the background of TCP. Even these institutionalisms have not a fruitful dialogue with TCP nowadays.

While transactional analysis had been applied to economic and organizational interactions by a relevant tradition of literature, the approach of TCP focuses on political transactions and he considers that “public policy is a sometimes explicit, sometimes implicit agreement (or transaction) among policy makers” (Spiller and

599 Tommasi 2007, p. 3). In this sense, we should point out the distinction between TCP
600 and politics of transaction costs: TCP is an analysis of diverse political processes
601 based on the existence of positive transaction costs and the governance solutions
602 that actors come up with in order to deal with them, whereas politics of transaction
603 costs in its original sense would be a direct application of economic policy that takes
604 into account the effects of positive transaction costs.

605 TCP assumes methodological individualism and studies political transactions
606 from a microanalytical perspective that tries to rigorously tackle positive political
607 analysis. TCP sustains that political institutions matter, that they can be analyzed
608 and that their effect is to economize transaction costs. TCP likewise construes polit-
609 ical activity as a dynamic process in evolution, which is incomplete and imperfect
610 and which takes place in “real time”, in history (Dixit 1996, 1998).

611 In the pre-coasean neoclassical world where transaction costs are zero, political
612 activity would correspond to a simple assignment of rights that would permit effi-
613 ciency through transfer of rights from owners who value them less to those that
614 value them more (no “Pareto improvement” would stay unexecuted) (North 1990b).
615 This situation allows us to derive a macro version of Coase’s theorem according to
616 which economic growth is not affected by the type of government of a country as
617 long as transaction costs are zero (Eggertsson 1990). But we can go a step further in
618 the reasoning process and conclude that in such an ideal world, the political process
619 would not matter, since an efficient plan would always be achieved (Dixit 1996).

620 TCP uses political transaction as the unit of analysis and explains the evolution of
621 political relationships as transactions and contracts. It highlights the relevance of in-
622 stitutions in political markets characterized by incomplete political rights, imperfect
623 enforcement of agreements, bounded rationality, imperfect information, subjective
624 mental models on the part of the actors and high transaction costs. The institutional
625 structure of polity acts as a set of rules that structures incentives, determines the
626 volume of transaction costs and biases political output.

627 The NIE has focused most of its efforts in demonstrating that passage of time
628 and history matter. North (1990a) defended the relevance of path dependence in
629 economic analysis, and the notion of path dependence has been integrated too into
630 the organizational studies. These features are also verified for political analysis and
631 were thus assumed by TCP (North 1990b; Dixit 1996). Therefore, such a trans-
632 actional approach also assumes the importance of history and path, which in turn
633 facilitates a greater contact with arguments of historical institutionalism. Really, his-
634 torical institutionalism has exercised influence on TCP through the foundations of
635 NIE. Literature furthermore has recently indicated the relationship between historic
636 institutionalism and the RCI. There are authors of historic institutionalism such as
637 Steinmo, Thelen and Longstreth, who appreciated the approaches of rational choice
638 and moreover Katznelson and Weingast (2005) have recently indicated that historic
639 institutionalism and RCI have many aspects in common and detect that there are
640 points of intersection and overlap between the agendas of both institutional ap-
641 proaches. Furthermore, and through its connection with RCI, the TCP program has
642 points that overlap with historic institutionalism, especially regarding the way insti-
643 tutions shape incentives and preferences of actors.

645 The other principal effort made by NIE has been to escape from strict rationality
646 models in order to highlight the importance of cultural and cognitive factors such
647 as beliefs, ideology and myths. In this way, the instrumental rationality approach
648 of RCI meant that “the actors either have correct models by which to interpret the
649 world around them or receive information feedback that will lead them to revise
650 and correct their initially incorrect theories” (North 1990b, p. 356). Nevertheless,
651 the NIE and TCP reject instrumental rationality and assume bounded rationality.
652 North’s (1990b, 1994) proposal includes the idea that individuals make decisions
653 based on subjective models, which had already been presented by Weingast (1996)
654 as one of the challenges of RCI. In this manner, transactional institutionalism sur-
655 passes the suppositions of RCI.

656 This opens the possibility of indicating that history and ideology matter in order
657 to understand politics. The novelty of this perspective is that it is justified through
658 an institutionalism that had initially strictly assumed the following two foundations:
659 methodological individualism and rational approach.

660 Regarding the main contributions of TCP, we should point out that North (1990b)
661 and Dixit (1996, 1998) are the two fundamental contributors who provided the theo-
662 retical bases for the program, while Weingast and Marshall (1988) and North (1989)
663 formed the two relevant precedents. An important contribution to TCP from politi-
664 cal science has been Epstein and O’Halloran (1999), which applied the transactional
665 perspective to the delegation of powers. It included a review of the theory of TCP,
666 and it showed several differences and similarities between economic and political
667 interaction. Taking some lessons from the theory of the firm, Epstein and O’Halloran
668 analyzed the hold-up problem in political transactions.

669 The approach of TCP is useful for organization studies. Public bureaucracy, dele-
670 gation to independent agents and political parties are three relevant issues on which
671 TCP has significantly contributed. Firstly, TCP assumes that the adequate insti-
672 tutions of governance will depend on the characteristics of each type of transac-
673 tions. Then, all models of governance (markets, hybrids, firms, regulation, public
674 bureaucracy, ...) should be considered if we want to determine the best organiza-
675 tional structure that minimizes transaction costs so much as possible. For exam-
676 ple, public bureaucracy is well suited to some transactions, such as the “sovereign
677 transactions” of which foreign affairs is an example, and poorly suited to others
678 (Williamson 1999). In this way, TCP incorporates several efforts to study gover-
679 nance structures and institutional design in the public sector (Estache and Martimort
680 1999; Gallego-Calderón 1999; Ruitter 2005). Secondly, delegation of power to in-
681 dependent agents—such as the central banks or supranational institutions like the
682 European Commission—is best understood as a means of reducing political transac-
683 tion costs (Majone 2001). In fact, there are empirical studies that show that in
684 the process of the autonomization of government organizations, strictly economic
685 aspects are less relevant than factors as bounded rationality, opportunism and social
686 institutions (Ter Bogt 2003). Thirdly, some contributions of TCP have tried to ad-
687 vance towards a transaction cost theory of political parties. Jones and Hudson (1998,
688 2001) explored how political parties reduce voters’ information costs and they argue
689 that if voters reduce transaction costs by relying on party signal, politicians have an
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