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PART II

THE UNINTENDED CONSEQUENCES OF HUMAN ACTIONS

INTRODUCTION

Whereas in Part One I discussed theories about the intended consequences of rational choices, in this Part I discuss the unintended consequences of intentional actions.

It is obvious that I start with invisible hand explanations, for they explain the very intriguing question how the uncoordinated actions of millions of people can result in an orderly society and in an efficient allocation of resources. It is clear that the solution must be that in the course of time unplanned coordination devices emerged.

I discuss two kinds of invisible hand explanations: one in which the coordination of all actions is regulated by the market, or more precisely, by the price mechanism and one in which the coordination is regulated first of all by institutions.

Invisible hand explanations explain how the actions of agents 'produce' the macro level. The micro-macro relation can take two appearances depending on the question whether or not we assume that the micro- and macro level define separate domains. In the traditional approach (of general equilibrium theory) it is assumed that they do not define separate domains. All we need to know about the macro level is how

individual agents maximize utility and then aggregate the outcomes. When it is assumed that the macro and micro domain have a more or less independent existence, then we have a *supervenience* relation.

In chapter VIII I discuss how the price mechanism is regarded in economic science as the mechanism that coordinates the multiple actions of individual agents. We immediately encounter a paradox, for to let the process of supply and demand result in an equilibrium price an auctioneer has to be introduced as if the model that represents a market economy is a model of a planned economy. In the process of formalization the concept of equilibrium is radically transformed. Originally it referred to the balance of market forces or to a situation in which every agent was able to execute his intentions, but ultimately the equilibrium concept became the solution of a system of equations. Nevertheless, even the formal approach did not succeed in proving the existence of a unique and stable equilibrium. The basic limitation of reductive models is that individual agents interact solely through the autonomous forces of the market. As soon as this independence is restricted and individual behavior is made interdependent or relational, meaningful restrictions in the class of aggregated excess demand functions can be obtained. But then we have entered an institutional approach.

The supervenience approach is in a formal sense rather empty. The question is what the supervening base for macro phenomena is, i.e., on what facts about individuals do macro facts depend. This can only empirically be determined. When the supervenience approach is combined with the theory of *emergent properties* then we may assume that the macro level is a relatively independent domain. The macro domain is, to be sure, dependent on the micro entities but not reducible to them. The conclusion is that it is futile to search for a unique equilibrium by relying solely on the price mechanism. The first attempt to explain the invisible hand has failed.

In a second attempt I use micro-institutional theories, to deliver explanations for the coordination of individual

actions. The legal, political, social, cultural institutions embody rule-led behavior and this ensures that reciprocal expectations emerge which lead to the coordination of individual actions. Institutions do not replace the price mechanism or authority relations, but supplement them and make them viable.

Within the micro-institutional approaches I distinguish two schools of thought. The combination of the property rights theory and the theory of natural selection delivers the neo-institutional theory. While the combination of transaction costs theory with the idea of the design of allocative and institutional arrangements delivers the new institutional theory. The neo-institutional theory remains close to neo-classical theory. These theories limit their attention to those institutions that have a bearing on the safeguarding and the transfers of property rights. The new institutional school takes more distance from mainstream theories and is focused on the comparative analysis of 'governance' structures.

A failing in both micro-institutional approaches is that the concept of institution is used indiscriminately. This is why I discuss the general nature and functions of institutions in chapter X.

Three features are central to the institutional theory that I present. First, institutional individualism that can be understood as a broad interpretation of methodological individualism, namely an interpretation in which events, states of affairs and so on, have to be explained with reference to the interaction of individuals and social structures. Institutional individualism accepts the existence of institutions as exogenous variables. This emphasizes the fact that institutions are both the product of human actions and constraints on human actions. The second feature is the distinction between constitutive and regulative rules, which makes the compliance problem easier to deal with. A third feature is a bargaining approach that combines the idea of the spontaneous development of institutions with the idea of the design of institutions.

A crucial feature of institutional individualism is that institutions are both conditions for and products of human action. Ther are two theories that try to give account of this phenomenon: Bhaskar's transcendental realism and Giddens's structuration theory. Both theories try to explain how individuals when they act unintentionally reproduce or transfrom institutions and social practices.

Bhaskar' s transcendental realism argues that social life is routine to a high degree and then asks the question: what must exist in order for such routine to be possible. The answer is rules, conceived as social structures. The primary focus of science is not the flux of events but the (hidden) generative structures that govern them.

The point of departure of structuration theory is the human capacity to intervene in the course of events. The making of history is the subject of analysis, not those who make it. The making has ontological priority; the analysis is focused on the mechanisms of social reproduction. Human activities are recursive, i.e., agents reproduce by their activities the conditions that made their activities possible. The recursive nature of social life is made possible by continuously repeated daily activities. Routine is a basic element of these daily activities. The circular, positive feedback from institutions to individuals and from individuals to institutions helps to enhance the durability of the institutional unit.

In Chapter XIII I compare transcendental realism and structuration theory. A deeply contested issue is whether social structures exist only in the activities they generate, i.e., do they only have a virtual existence or do they exist independent of individual agency. Whereas Giddens defends the inseparability thesis, Bhaskar argues on the one hand that social structures only exist in the activities they generate, but on the other hand he says that social structures are causal conditions for activities. Thus, social structures appear both to be internal to human activities and external. The idea that social structures are causally efficacious is based on the combined notions of *emergent* structures and *downward causation*.

In chapter XIV I summarize the main points of criticism that I raised in the Parts I and II, and present the main features of an institutional approach to rational choice theory. In doing this I distinguish two models of rational choice theory: the competitive and the comparative approach. The competitive model is a combination of property right theory, evolutionary (game) theory and neo-institutional theory. It is the model of generalized exchange and managed competition in non-market settings. The comparative model is a combination of transaction costs theory, bargaining theory and new institutional theory. Its aim is a comparative analysis of governance structures.