Rational Choice and Dysfunctional Institutions

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As stated elsewhere in this issue, we cannot claim to explain an institution's origin just by the functions it serves. In part this may be because of the cognitive limitations of those actors who are instrumental in institutional formation and institutional change. But even more clearly, it is the case that rational instrumental choice does not imply functional institutions. Just as rational choice in a prisoner's dilemma may result in inefficient policies, rational choice by actors with conflicting preferences for institutions may result in institutions that are suboptimal. Examples of rational choice explanations of dysfunctional institutions are provided in the area of bureaucracy, regulation, healthcare, and budgeting. I argue that the paradoxes and impossibility results of rational choice theory offer the best insights currently available into the persistent inefficiencies of the world of politics.

The rediscovery that institutions impact outcomes has led naturally to a renewed interest in the origins of institutions. Rational choice models have played a significant role both in the understanding of how institutions matter and in the study of where institutions come from. However, two thoughtful papers in this issue raise important questions about the applicability of rational choice models to institutional design. Simon Reich argues that rational choice models, in the form of new institutional economics, are primarily applicable to the study of regulation policy, while the assumptions of rational choice do not prove helpful in the study of redistribution, modernization, or liberalization. Paul Pierson examines the "limits of rational design," providing interesting reasons why we cannot attribute the functional features of an institution to the instrumental choices of its designers. We cannot say the congressional committee system exists *because* it enhances legislative stability, nor can we say that firms exist *because* they solve various contracting problems between parties.

I strongly agree with Pierson with regard to the functionalist premises of social science research: we cannot claim to have explained an institution's origins simply by reference to the institution's functionality. However, my path to that conclusion would differ in some key respects from Pierson's. I will try to lay out an argument about institutional change that

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is perhaps complementary to Pierson's, and that will give a slightly different perspective on the role of rational choice theory.

I will proceed by first examining one of Pierson's key arguments, regarding the noninstrumental nature of institutional choice. I will claim that constructing models of institutional design based on instrumental choice is still a worthwhile endeavor. The second half of the paper argues that instrumental choices need not imply functional institutional outcomes; therefore, instrumental choice is logically insufficient as an explanation for functional institutions, as Pierson claims. In fact, I will argue that rational choice models are peculiarly suited for understanding the *dysfunctional* features of institutions, and that dysfunctionality remains a prominent problem in understanding institutions.

NONINSTRUMENTAL AND INSTRUMENTAL INSTITUTIONAL CHOICE

Pierson's first critique of the rational design of institutions is that "institutional designers may not act instrumentally" (478). This is a fundamental criticism of rational choice. The rational choice modeling enterprise assumes that people act to pursue their goals; that is, the actions people choose must be in some sense instrumental with regard to their goals. If this is not the case, then our attempts to model the choices of individuals should be based on whatever noninstrumental factors *do* determine those behaviors.

I have no quarrel with the *possibility* of noninstrumental behavior in the social sciences. Indeed, if nonrational choice were not a possibility, then rational choice would be a tautology.

Noninstrumental behavior in politics is made plausible by observation of everyday behavior. Beginning with the more extreme examples, we know that schizophrenics and other victims of mental illness behave in ways that are not productive of their own goals. Alcoholics and drug addicts are defined by the fact that their actions are self-destructive rather than instrumental. Neurotics, including those suffering from obsessive-compulsive disorder, are aware that their own actions are not in their own interests, but feel compelled to do them anyhow. It is obvious that rational choice models have little to offer the study of these important problems.

A little honest introspection on our part reveals that we all take some actions that are inconsistent with our own interests as we understand them at the time. We take a second piece of chocolate cake, even though that behavior is destructive of our firmest, most deliberate plans to lose weight, and deeply regret our behavior during and after the act. We recognize that much of our behavior is driven by hormones in interaction with genetic tendencies that may deviate strikingly from self-conscious action in pursuit of our own most fundamental goals.

I would readily agree that a significant portion of everyday behavior is noninstrumental and nonrational. The interesting and important question is, What is the domain of rational, instrumental behavior? And in particular, Does that domain include market behavior and political behavior?

Noninstrumental behaviors of politicians (for example) occasionally have enormous political consequences. Bill Clinton's dalliance with a White House intern is a case in point. Because of its consequences, the episode motivated a great deal of public speculation by professionals of various sorts on Clinton's sex drive. There was a great deal of professional belief (supported by Clinton's own admission that he was seeking religious counseling) that his sexual behavior was "out of control"—that is, it was subversive of Clinton's own deeply held political goals. Monica Lewinsky's own testimony (if it can be believed) is that Clinton himself agonized over his sexual behavior, constrained it for long periods of time, only to "lose control" periodically in the face of temptation. As a rational choice political scientist, I am perfectly willing to step aside and let psychologists attempt to explain this particular political behavior.

On the other hand, this admission does not mean that I am giving away the store. I would claim that the most important empirical observations can be explained *without* resort to the psychotic, neurotic, or normal hormone-driven behavior that is not the result of calculations of our own best self-interest. The claim is that we can understand the milk price support system without reference to our subconscious links between the concepts "milk" and "breast" and "motherhood." We can understand a senator's support for military expenditures in his state without reference to a neurotic need for power, the evolutionary tendency toward violence of the human species, or the obvious resemblance of a missile to a cigar. Sometimes, to paraphrase Sigmund Freud, a missile is just a missile.

The (Limited?) Domain of Rational Choice in Politics

Because it is not implausible that irrational forces are important in politics, the successes of rational choice models are all the more striking. I cannot read the literature on congressional committees, on delegation to bureaucracies, on interest group formation and lobbying, without being struck by both the theoretical impact of rational choice and the *empirical success* of theories based solely on the instrumental, calculative choices of goal-oriented political actors (Aldrich and Rohde 1998; Snyder and Groseclose 1999; Epstein and O'Halloran 2000, to name but a few recent examples).

Contrary to some of the critics of rational choice, it is not an ideological commitment to the notion that all people are instrumental at all times that keeps rational choice modelers working at the rational choice enterprise. It is the *empirical success* of models that assume instrumental behavior by lobbyists, legislators, and bureaucrats that keeps rational choice modelers optimistically plugging away.

On the other hand, to say that rational choice models have been successful in some areas is not to say that they have been successful in all areas. It seems apparent that rational choice models have been most successful in those areas in which the prospect of large concentrations of economic resources at risk have focused the conscious, strategic cognition of all the relevant political actors. The politics of weapons contracts, of agricultural subsidies, and of trade policy have all demonstrated a careful calculation by interest group lobbyists, legislators, and bureaucrats involved in the formation of policy. Other citizens, whose economic interests are not directly at risk, demonstrate rational ignorance and rational passivity, allowing policy outcomes in these bread-and-butter issues to be determined by the economic interests of those who are most intensely at risk (Olson 1965).

But not every policy choice involves bread-and-butter issues. Civil rights, abortion, and same-sex marriages often invoke heated outrage on the part of various political actors, rather than cold calculation. Passion in politics does not rule out rationality, of course. In a minimal sense, rationality simply implies a goal-oriented behavior. If one voter's goal is a burning, religious desire to eliminate abortion in the United States, she may pursue this goal in a perfectly rational way. On the other hand, she may not. Is it not possible that a voter aroused by the issue of abortion will go to the polls when her vote has little chance of impact, vote in a way that ignores her best interests on other less passionate issues, make costly contributions to hopeless causes without benefit of selective incentives, and otherwise act in ways that are notably noninstrumental? And if she and thousands or millions of other voters act in this noninstrumental way, how much leverage will our normal rational actor models give us on the policy outcomes (Muller and Opp 1986; Chong 1991)?

This concern is the basis, it seems to me, of Reich's attempt to limit the domain of rational choice models to the area of regulation. Having just admitted that the jury is still out on the question of the efficacy of rational choice models in more heated, ideological politics, I cannot dismiss Reich's attempt out of hand, as many rational choice scholars of course would. However, by the end of the paper, I will attempt to modify to some extent Reich's basis for making a categorization regarding the scope of rational choice with regard to institutional design.

Before attempting that, however, it is important to address Pierson's point about functional explanations directly. In particular, I have claimed that at least some policy decisions can be understood as the result of instrumental choices by goal-oriented lobbyists, legislators, bureaucrats, and other political actors. If that is the case, why should it not follow that we can explain *institutional* choices by reference to the beneficial functions performed by those institutions for the political actors who design them?

RATIONAL ACTORS CHOOSING DYSFUNCTIONAL INSTITUTIONS

As Pierson notes, "[F]unctionalist treatments of institutions are prevalent in political science. They are common, for instance, among those who emphasize the rational choices of individual actors that underlie political activity, and the reasonably efficient nature of collective responses to social needs" (476). I agree that such explanations often deteriorate into a tautological exercise that adds little to our understanding of institutions. For example, the organizational economics discipline tends to "explain" the existence of firms as the efficient resolution of contractual problems (Alchian and Demsetz 1972; Klein, Crawford and Alchian 1978; Fama 1980; Cheung 1983; Jensen 1984). In this literature, the theoretical exercise of pointing out contractual inefficiencies that may be resolved by the creation of a firm is too often regarded as an end in itself. Rarely are falsifiable hypotheses carefully drawn from the theory, and even more rarely are attempts made to gather the information that would be required to test those hypotheses. The creation of the hierarchical firm is seen as rational action without flesh-and-blood actors.

This approach has several problems. In the case of organizational economics, the entire literature tends to ignore that the same contractual problems that are supposed to be resolved by the creation of the firm *re-appear within the firm itself*, creating the dilemmas that constitute the challenge of effective management (Miller 1992). Furthermore, the literature provides no reason to believe that the resolution of those contractual problems was in fact uppermost in the minds of any of the institutional actors at the time they participated in the creation of the firm.

Unintended, Long-range Consequences Do Not Rule Out Rational Choice Explanations

Pierson notes two other reasons institutions may not be functional, even if the designers are instrumental. One is that, in designing institutions, actors may not anticipate the effects of institutions on policy outcomes correctly. He also notes that actors may have quite short time horizons. These two points are closely related, in that there are more unanticipated effects beyond the actors' short time horizons than within those horizons.

Both of Pierson's points are empirically unassailable. Clearly, people do have short time horizons, and they fail to anticipate all the effects of the institutions they design. The Founders could hardly be expected to have anticipated all the long-term implications of Section 5 of Article I, which says in part that "each house may determine the rules of its proceedings." Yet this rule has, over time, been a primary prop for institutional conservatism in the U.S. Senate and in its Rule XXII allowing filibusters. This one rule has had enormous policy consequences over the twentieth century, and efforts to change it have been limited by the fact that it is to some extent self-referencing—that is, it takes a filibuster-proof majority to change the rules about filibusters.

Nevertheless, I claim that unanticipated long-term consequences do *not* call into question the viability of rational choice explanations of institutions. Rational choice does not require omniscience on the part of actors. It requires that actors make instrumental choices on the basis of their understanding of the effects of their actions. If some citizens vote for term limits because they think it will result in less pork-barrel spending, then the unanticipated consequences of term limits (which may include increased special interest influence) do not lessen the fact that the crucial citizen choices were instrumental and goal-oriented.

Pierson is correct in noting that unanticipated long-term consequences *do* cause problems for simple, functionalist institutionalism. We cannot point to beneficial effects of various rule changes as "causes" for the rules, unless we know that those beneficial effects were both anticipated and desired by the rule changers. This requires more than a theoretical demonstration of the desirable effect. It requires some historical and/or empirical account of the expectations and motivations of the actors at the time that the critical choices were made.

A growing number of examples allow us to point to a rational choice literature on institutional change that avoids the pitfalls of functionalism pointed out by Pierson. These are cases in which institutional design is explained by reference to the instrumental choices of the designers, on the basis of the short-term, understood effects of the institution in question. Rather than explaining the institution by the functions it would provide for the actors at the time, the institution is explained as the result of self-interested actors making instrumental choices based on their understanding of the effects of their decisions on their own goals. Some of the most interesting of these cases are gathered in the book *Analytic Narratives* (Bates et al. 1998). The case studies in this book do not regard the long-run functions of the institution as sufficient explanation for the short-term institutional choices of the actors. On the contrary, they examine in close historical detail the expressed motivations and perceptions of the new institutions. For instance, Alan Greif (1998) explains the creation of the *podesteria* in Genoa in the twelfth century, in which the main features of the economic and political system are the result of coalition formation between self-serving representatives of different clans.

Examples such as these, and including Ensminger 1992 and Schofield 1999, show that short-term time horizons and unanticipated consequences do not pose an insurmountable obstacle to rational choice explanations of institutions. Nor do they demonstrate the functionalist fallacy that Pierson correctly warns against.

Rational Choice and Functionality

While unintended, long-range consequences are important to a complete understanding of institutional effects, they are not necessary to explanation of dysfunctional institutions. Rational actors, in the aggregate, can choose dysfunctional institutions *even when, as individuals, they perfectly understand what they are doing*. Indeed, the most fundamental results in rational choice have given us good and sufficient reasons for *expecting dysfunctional results from rational individual choices*.

The simplest example is the prisoner's dilemma game. This game has been the focus of constant attention, not to mention fascination, because it presents in the simplest possible way the disconnect between rational individual choices and inefficient social outcomes. Choosing one's dominant strategy would seem to be the weakest possible requirement of individual rationality; yet in a prisoner's dilemma game, the outcome resulting when each player chooses her dominant strategy is one that all can agree is inferior to some other outcome.

There is no special reason to believe that choices over institutions are not subject to similar prisoner's dilemma problems. Bureaucratic dysfunctions are an example. Bureaucracies that continue in inappropriate standard operating procedures long after they have lost sight of their initial purposes are a part of the common perception of government. One standard mode of explanation is to refer to cognitive limitations of the bureaucrats themselves. However, bureaucratic dysfunctions may exist *because of the rationality of bureaucrats*, not because of their cognitive limitations or inability to see long-term consequences. Warwick's *A Theory of Public Bureaucracy* (1975) explains State Department rigidity in terms of the rational responses of Foreign Service officers to a hostile political environment and a personnel system that rewards mediocrity. In general, Jack Knott and Gary Miller (1987) argue, many dysfunctional bureaucratic institutions may result from the perfectly rational calculations of individual subordinates, superiors, and legislative overseers.

Terry Moe (1989) traces bureaucratic dysfunctions even further, to the rational complicity of interest groups and legislators. His conclusion is that, for self-interested and sufficient reasons, rational actors representing powerful interest groups may negotiate inefficient regulatory solutions. The interest groups who control Congress at a moment in time might prefer an inefficient regulatory regime that protects their interests over time rather than an efficient regulatory regime that can be altered at the next election.

The attempted Clinton health reform illustrated this nicely. No one was particularly happy with the current institutions of healthcare, but no interest group was going to give up its autonomy over those aspects of the system that were most critical to it. The problem was that achieving a more efficient institution required a degree of trust and cooperation that was not present in the system. The result was maintenance of an institutional status quo that no one tried to defend, except by reference to possible alternatives that they portrayed as even worse.

Aaron Wildavksy's account (1984) of subversion of the mid-century congressional institutions is a particularly brilliant example of social dysfunctionality resulting from rational individual behavior. He explains that proponents of major congressional programs worked hard to find their way around the budgetary safeguards of the Appropriations Committee. Members of Congress, he wrote,

> got their way, in a manner of speaking, by riding roughshod over the appropriations committees, by tunneling beneath them through direct drafts on the Treasury ("backdoor spending"), or by getting around them entirely through tax expenditures (spending that allows certain people to reduce their taxes before these taxes get to the Treasury), or through loans and loan guarantees, which, except for defaults, do not count on the budget as direct spending. Individual members of Congress won but Congress as a whole lost; individual and collective rationality were at odds" (1984, 223).

The rules of the game that governed budgeting during the seventies, eighties, and nineties were the inefficient equilibrium of an institutional prisoner's dilemma game.

In fact, the impossibility results that have provided the deepest insights into group decisionmaking have all portrayed some aspect of this problematic dysfunctionality of rational choice. Kenneth Arrow (1963) argued that a nonmanipulable, democratic social choice mechanism could not be both stable and Pareto optimal. Amartya Sen's paradox (1976) could be interpreted as arguing that no decentralized institution could guarantee both stability and Pareto optimality (Miller 1993). Bengt Holmstrom's "Moral Hazard in Teams" (1982) showed that any budget-balancing resource allocation mechanism in an interactive team could have no efficient Nash equilibrium. The most profound tension in rational choice theory has been between individual rationality and social inefficiency.

In other words, there logically *is no link* between individual rationality and efficiency in social choice. To put the case rather perversely, a discovery of beneficial properties in an institution should be immediately the cause of greater curiosity and interest by rational choice modelers. Institution X does task Y particularly well? How can that be? Weren't the people who designed the institution rational? If so, how did rational people ever get together to design an institution that actually works? The dysfunctional institutions that interest Pierson follow from rational choice more surely than the arguments he relies on in his paper. We cannot regard the functional properties of any institution as a sufficient explanation for that institution's existence, because rational individuals frequently fail to achieve efficient outcomes.

Of course, I exaggerate somewhat to make a point. Nothing in the great impossibility results of rational choice political economy requires constant social failure—it simply claims that failure can never be ruled out. From this perspective, institutional efficiency would seem to be one of the great empirical problems to be explained, along with large-turnout elections, successful large-group collective action, and stable majority-rule decisionmaking.

In light of the logical difficulties in aggregating rational individual choices into beneficial social outcomes, "unintended consequences" takes on a slightly different role than that attributed to it by Pierson. For Pierson, "unintended consequences" limit the applicability of rational choice to institutional design. A slightly different way to think of it is that "unintended consequences" may explain why rational individuals in pursuit of one set of goals stumbled onto a more beneficial institutional design than they intended.

For instance, the Founders, gathered in Philadelphia to discuss a new constitution, were divided between supporters of Madison's Virginia plan (which based legislative representation on population) and the contrary New Jersey plan (which represented the states). There is an instrumental explanation for why the representatives of different states supported the constitutional features that they did. The Great Compromise was no one's first choice; yet it has provided the basis for an effective bicameralism that has played a role in legislative stability and a flexible form of evolving and successful federalism. Surely here was a case of beneficial unintended consequences. If any of the Founders had had their way, the Constitution would not have been the flexible instrument of federalism that it has turned out to be.

Functionality and Regulation

It will be apparent from this argument that I have my differences with Simon Reich's characterization of the usefulness of "the new economic institutionalism." Reich believes that the new economic institutionalism is peculiarly appropriate for understanding regulation, which is

> carried on between and among actors seeking to gain greater efficiency (or arbitrate differences across systems to avoid friction) through cooperation. . . . The search for solutions to common problems that cannot be resolved unilaterally leads to the adoption of new structures that reflect the assumptions of the "new economic" institutionalism (503).

However, the search for cooperative solutions to common problems is *not* the defining feature of most of the literature on new economic institutionalism. While some new economic institutionalists, notably Oliver Williamson (1975), sometimes sound like functionalists, most new economic institutionalists are grounded in rational individual choice, and the defining feature of rational choice models is the attempt to explain behavior as a result of the instrumental choices of individuals pursuing their own individual goals. If efficiency and cooperation are the primary goals of the actors involved, then it is not a rational choice model.

A major accomplishment by game theorists has been to explain how cooperation and efficiency *may at times result* from the instrumental behavior of individuals (Axelrod 1981). Because of their success, rational choice seems to have the capacity to explain a larger range of beneficial outcomes than appeared to be the case twenty years ago. However, it is still an easier task to explain inefficiency and failures of cooperation than the opposite.

Luckily for rational choice theorists, regulation (in contrast to Reich's characterization) can often be defined as being *carried on between and among actors seeking to gain individual advantage by carrying economic* *competition into the political marketplace. The search for competitive advantage leads to the adoption of sometimes grossly inefficient regulatory structures, reflecting the conclusions of rational choice modelers*. Competition-squashing regulatory regimes like those historically imposed over interstate commerce, the airline industry, and the securities industry; the inefficient entry barriers raised by occupational safety regulations and consumer safety regulations; the competitive advantage offered by large firms over small firms resulting from stricter environmental regulation—all of these noncooperative and inefficient institutional patterns in regulatory policy have been addressed with notable success within the new institutional economics (for a seminal example, see Stigler 1971). Indeed, the only real challenge for new institutional economics has been to explain *deregulation;* the puzzle is to show how such an efficiency-enhancing regime change could result from the self-interested behavior of firms, lobbyists, and politicians who were doing quite nicely under the old regulatory regime (Weingast 1981).

Thus, I agree with Reich that rational choice, in the form of new institutional economics, is peculiarly appropriate for studying regulatory politics, but not because regulatory politics is that arena which is characterized by cooperative efforts to achieve efficiency—but because regulation is an aspect of public policy where raw, calculating self-interest has such untrammeled impact on the final outcomes.

I also feel that rational choice models can make a significant contribution to the study of the "substance of politics over the division of scarce resources"—Reich's definition of redistributional politics. The competition over scarce resources is almost definitional for the subject matter of rational choice political economy. Jack Knight's *Institutions and Social Conflict* (1992) is an example of a new institutional economics approach to redistribution. The possibility that "some groups win while others lose" certainly does nothing to rule out new institutional economics as an explanatory approach.

This does not mean that "historical institutionalism," which Reich identifies as the "most appropriate form of institutional analysis," has nothing to offer redistributional policy. On the contrary, I would suggest rather that historical institutionalism and new institutional economics are natural complements, rather than competitors—in the study of *both* regulation and redistribution. I would hate to imagine that the world would be parceled in such a way that scholars associated with historical institutionalism and institutional economics would have nothing to say to each other. Indeed, the synergies of combining rational choice and historical analysis have motivated some of the newest work in institutional analysis, most notably the *Analytic Narratives* research of Robert Bates and his colleagues. The authors using this approach have explicitly rejected the kind of specialization and division of labor implied by Reich's four-way categorization in favor of interdisciplinary cooperation to explain a variety of different kinds of policies; indeed, the central policy issues in *Analytic Narratives* are Reich's third and fourth policy arenas: modernization and liberalization.

CONCLUSION: EVOLUTION AND LEARNING

Pierson argues that, since we cannot assume rational institutional designers will inevitably produce functional institutions, we should supplement rational design with evolutionary and learning theories. He then proceeds to provide a series of reasons why evolution and learning, too, are not going to guarantee functionalism.

Here again, I am in substantial agreement with Pierson; but once again, my reasons are more sympathetic to what rational choice theory has to bring to the story.

Pierson argues that politics is less vulnerable to competitive pressure than markets, and more resistant to change. I agree. However, this resistance to change can be explained by rational choice institutionalism, as an example of equilibrium. Indeed, Andrew Schotter (1981), Randall Calvert (1995), and others have argued that institutions *are* equilibria. And, definitionally, equilibria cannot be changed by one person changing his or her action, whether the equilibria in question are efficient or inefficient. Thus, the rational choice analysis of institutions as equilibria provides powerful insights into what Pierson regards as the problematic stability of inefficient institutions.

Douglass North (1981; 1990), whose books instigated so much of the work on institutional design, emphasized that throughout most of history, political institutions defining property rights and contract enforcement have been grossly inefficient and the fundamental obstacle to the development of more efficient economics. The political institutions in early-modern Spain and France were equilibria in that political rulers had every incentive to protect their prerogatives, and other political actors normally had every incentive to find a niche in the patronage flows that came from the ruler, rather than taking the politically costly path of fighting for the autonomy of markets. None of this requires more than an understanding of rational actors and the incentives they faced under the institutions, and the disincentives for institutional change. Once again, rational actor models do a rather compelling job of explaining the stability of inefficient institutions.

My differences with the authors thus are perhaps more a matter of emphasis than substance. I agree that functionalist premises about institutional origins are not defensible; I caution that rational actor models need not operate from functionalist premises. I agree that important aspects of social behavior may not be instrumental; but that makes the successes of purely instrumental explanations in politics the more compelling. I agree, with Reich, that rational choice models have not had uniform success across a variety of different policy arenas; but I would beg for cooperation with historical and other forms of explanation, rather than specialization within narrow policy arenas. Most important, I agree with Pierson that some models "suggest a world of political institutions that is far more prone to efficiency and continuous refinement . . . than the world we actually inhabit"; but I insist that the paradoxes and impossibility results of rational choice theory offer the best insights currently available into persistent inefficiencies in the world of politics. I would therefore hope that the readers of this special edition would be sympathetic to those who intend to proceed with a research agenda premised on instrumental choices of goal-oriented political actors, and motivated hopefully not by dogmatism, but by a healthy, open-minded skepticism.

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