

The Social Provisioning of Goods and Services: A Dynamic Approach to the Alignment of Transactions with Governance Structures

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Abstract: Original institutional economists and the transaction cost economist Oliver Williamson have inquired into social provisioning of goods and services. Original institutional economists may build upon the achievements of Williamson’s static approach. This might be done by incorporating the struggle for power into his analysis of governance structures. The struggle for power, which might be socially motivated, materializes itself in the form of a change in: mark-up, the institutional environment of governance structures, the instruments of governance structures, or the dimensions of transactions. A series of behaviors might be enforced that endorse these changes. Simultaneously rules might become circumvented by bounded socialized actors who oppose them. In turn, this fosters further amendments, as is shown by referring to Obamacare.

Key words: Transaction Cost Economics, Rationing, social provisioning, health care reform

JEL codes: B52, D23, I18

Institutional economists, among others, the 2009 Nobel Laureate Oliver Williamson, approach transactions from the perspective of social provisioning. (Dugger 1996, 41-42) The object of study of social provisioning is governance of “economic activities, mediated by culture, ideology and institutions.” (Figart 2007, 394) It requires an interdisciplinary approach (Williamson 2010, 673) and should highlight the interaction between economic and social behavior rather than equilibrium (Dugger 1996, 42).

Williamson’s Transaction Cost Economics (TCE) is static in nature. Original institutional economists (OIE) may build upon the achievements of TCE. With their historic approach and focus upon dynamic relations, they may get out of the limits of Williamson’s comparative statics approach. (Hodgson 2010, 303) This might be done by incorporating the struggle for power into the analysis.

The present article integrates power into Williamson’s governance structure model. Section 2 recaps Williamson’s theory. Section 3 summarizes the main criticisms of his model. Section 4 introduces power as a relevant factor for alignment of transactions with governance structures. Some interaction effects are elaborated with regard to the 2010 health reform or its commonly known sobriquet Obamacare. Section 5 rounds up with a conclusion.

Williamson’s theory of alignment of transactions with governance structures

Williamson (1999, 1088) adopts John Commons’s notion that transaction is the basic unit of analysis. He (1993, 453-454) distinguishes only calculative transactions and ignores Commons’s (1990, 55) three inseparable units of activities: bargaining, managerial and rationing transactions. Transactions are defined as alienations and acquisitions of intangible property rights. These activities occur in larger units of activity, namely, going concerns. The latter are “a joint expectation of beneficial bargaining, managerial and rationing transactions, kept together by ‘working rules’

and by control of the changeable strategic or 'limiting' factors which are expected to control the others." (Commons 1990, 58) This concept is replaced by Williamson (1999, 1088) with that of "governance structures".

Governance structures are "an economizing response to (. . .) conflict, mutuality and order." (Williamson 1999, 1088) They "settle the role, rights, duties, and expectations of transaction partners" and comprise institutions and instruments to enforce rules. (Spithoven 2012, 429-430) Broadly defined, institutions are human made "rules that structure behavior and social interaction." (Groenewegen, Spithoven, Van den Berg 2010: 25) The institutional environment of governance structures embraces: contract law regime, security of assigned property rights, reputation as a trustworthy transaction partner, and ex-post uncertainty—that is, the propensity of agents to exhibit moral hazard. The instruments of governance structures include administration (for preparing and monitoring contracts), adaptation (autonomous or co-operation), incentives, and contract law execution (autonomy, job security, legalistic dispute settlement).

Williamson's (1979; 1981; 1991a) theory comprises the following hypotheses:

- 1) Economic agents make rational decisions with regard to transactions under the condition of incomplete and imperfect information. They are bounded rational.
- 2) Transactions are organized within governance structures.
- 3) Governance structures differ in institutional design (combination of the institutional environment variables) and application of instruments.
- 4) Safeguarding transactions might be desired because of mistrust in: settlement mechanisms, protection of fruits of productive efforts, someone's reputation, or enforcement of contracts (moral hazard).
- 5) Safeguarding transactions entails governance costs.

- 6) Governance costs are a function of given preferences or dimensions of transactions—that is, frequency, ex-ante uncertainty (adverse selection) and asset specificity (transaction specific investments) of transactions.
- 7) Given their differences in institutional design and application of instruments, different governance structures differ in governance costs.
- 8) Economic agents economize on governance costs.
- 9) Ignoring managerial discretion (sales maximization, growth maximization, expense preference) (Williamson 2010, 675), economizing agents choose the governance structure with the comparative lowest governance costs.

The concept of governance costs comprises transaction and managerial costs. Transaction costs are costs involved in preparing, concluding, interpreting, monitoring, and enforcing contracts (Hodgson 2004, 409). They are related to bargaining in the market. Managerial costs concern costs with regard to executing rules that are collectively decided upon (Commons 1990, 64, 734).

Following Williamson (1981, 555), who focuses upon asset specificity as the main dimension for describing transactions, Figure 1 shows the governance costs function in a two-dimensional graph. It provides a comprehensive version of Williamson's complex governance contracting scheme by including public governance structures (Spithoven 2012, 6) and gift exchange (Dolfsma and Spithoven 2008). It shows that the governance costs curves of the different governance structures intersect each other. In Figure 1, the hierarchy is the most efficient governance structure for transactions between level 2 and level 3.

INSERT FIGURE 1 HERE

Criticisms of Williamson's model

Williamson's model is subject to several criticisms. First, from the perspective of Commons's analysis, he might be criticized for disregarding the struggle for power over others (hereafter abbreviated to struggle for power or power) and, in line with this, for ignoring rationing costs. Commons (1990, 302-303) defines power as the authority to hold back goods and services people want but do not have, and, to negotiate transfers of property rights according to the working rules and culture of society. Its exhibition is materialized in the form of bargaining and rationing transactions (Commons 1990, 761). The latter concerns negotiating arrangements between several stakeholders who are entitled with authority to distribute costs and benefits over members of a collaborative effort. (Commons 1990, 67-68) Arrangements between stakeholders concern the institutional environment or the dimensions and instruments of governance structures.

According to Williamson (1981, 572; 1985, 125), the exclusion of power is justified because it eliminates efficiency from the center of the analysis. Next to this, he (1991b, 81) states that power dependencies are anticipated in the TCE approach: They are priced out and addressed with proper safeguards and related organization responses. Finally, he (2000, 611) argues that power interpretations of the choice of institutions are tautological in character.

A second criticism of the TCE model is its static character. (Hodgson 2010, 300) This leaves unimpeded that Williamson has opened his model for a dynamic analysis of hierarchies. According to Williamson (1998, 33), TCE is "an intertemporal, adaptive and managerial exercise", namely:

- a. Alignment of transactions with governance structures should not be decided upon without the incorporation of its strategic implications. (Riordan and Williamson 1985, 375)

- b. The integration of strategy into the analysis allows for answering the question how firms should organize a certain transaction given its strengths and weaknesses. (Williamson 1998, 48)

A third criticism is that Williamson ignores fundamental uncertainty (Williamson 2012, 430). He focuses his analysis upon calculative transactions (Williamson 1993, 453-454) and with this upon risk. Risk is the probability of a set of given possible outcomes, whereas this set is unknown under uncertainty. (Groenewegen, Spithoven, Van den Berg 2010: 15-16) Due to the impossibility to calculate with unknowns, organizations cannot minimize costs or maximize profits. They only can hope to diminish uncertainty and influence profits or costs through co-operation. Co-operation is just another governance structure “to avoid destructive competition and ensure companies sufficient revenues and hence profits to remain going concerns.” (Spanberger 2015, abstract)

A dynamic approach to governance structures

A dynamic approach to governance structures may be provided by including the struggle for power into the analysis. This might be done in two ways. First, through including rationing costs. Lobbying, collective bargaining, collusion, co-operation, log-rolling, suing, and bribing might facilitate rationing. They involve a rise in costs and shift up the governance costs curve in Figure 1. Second, through integrating a mark-up in the cost-curve. A mark-up might be one of the results of rationing. A higher mark-up coincides in the private sector with higher pay-offs for capital owners and in the public sector with higher taxes or fees. If mark-up pricing more than offsets rationing costs, then the curve shifts down again. If a chosen governance structure is not the one with the (tentative) lowest costs, or certain transactions are aligned with different governance structures,

then this might indicate that managerial discretion, among which the desire to hedge for uncertainty, is at stake.

The struggle for power occurs between “citizens of going concerns” (Commons 1990, 74) or, in sociological terms, between actors, and concerns conflicts of interests over changes in ownership of wealth, income, and privileges. These conflicts are content dependent (Dugger 1996, 32-33; O’Hara 2014, 280) and embedded in culturally and ideologically defined working rules together with control mechanisms of going concerns. For example, within Anglo-Saxon countries the struggle for power is focused upon stockholder-value, and is accordingly organized, whereas in continental countries this is stakeholder-value.

The interactions between the struggle for power and institutions evolve in the background of Figure 1. They might be analyzed in a structure-institutions-actors model, whereby structure represents the power distribution over stakeholders. The struggle for power may result in a decision to adapt institutions. A series of behaviors might be enforced that endorse these changes. However, the less a hard-won change is supported by bounded socialized actors, (Spithoven 1998, 653) the more likely efforts are made to enforce substantial adaptations. In turn, a reallocation of rights and duties affects the power structure and with this the struggle for power itself, etcetera. So, intermediated by the support of bounded socialized actors, a decision to change institutions dynamically interacts with changes in the distribution of power.

The dynamics of Obamacare

Obamacare is an outstanding example to illustrate the dynamics of governance structures. (Spithoven 2012) With the Democrats winning the elections, the reform took the shape of a mandated insurance for individuals in tandem with the provision that prohibits insurers to deny insurance. The reform was a narrow victory of the Democrats and became heavily contested by the

Republicans. The struggle for power between the Democrats and Republicans resulted in several reform adaptations.

In 2009, almost one third of the Democrats in the House of Representatives preferred a single-payer option—that is, public coverage. (McDonough 2012, 45) Given the minority position of these single-payer advocates, this option was not feasible. Also the successively proposed public option (a government run health insurance) was beaten. However, both alternatives are not dead. They depend on the success of the reform in conjunction with the party composition (power structure) of Congress. (McDonough 2012, 47, 137)

In terms of Williamson's theory, the reform significantly changed the assignment of property rights and with this the institutional environment of health care transactions. Notwithstanding Obamacare's (§3403) anti-ration rhetoric, the reform exchanged some private for public rationing next to a higher public mark-up in the form of revenue offset provisions (§9001-§9017).

Before the reform, private rationing took the form of rescinding healthcare coverage if one became sick. The reform banned rescinding coverage. Other forms of private rationing still occur in the form of shifting costs to the insured (Kaiser Family Foundation 2014). The latter may result in avoidance of care due to high costs. Obamacare (§1402(2)(2)) tries to curtail this by the provision that limits cost-sharing.

The reform introduces some public rationing through changing arrangements between stakeholders that might limit (the growth of) the level of care consumption. These arrangements are, among other things: taxing "Cadillac" or "gold-plated" insurance plans, (Plotrowski 2013) the shift in costs to Medicare patients (Kuttner 2013), and, IPAB's physician payment policy. (Ebeler, Neuman and Cubanski 2011, 4, 16)

The change in property rights affected the dimensions of transactions. It influenced the dimension *ex-ante* uncertainty. Namely, the individual mandate, community rating, limiting the

provision of low quality health care plans and subsidizing beneficiaries to buy insurance diminished the adverse selection that was caused by forgoing insurance and medical underwriting. The latter concerns the use of personal health status data to decide upon applicants' healthcare coverage.

The reform also influenced the instruments. Administration costs may fall due to possible less tailored health policies (minimum standard, taxing Cadillac plans). A fall in administration costs might also become induced by new norms such as the provision that sets a maximum ratio for administration costs. Next to this, the reform might raise health care administration costs due to the complex system of subsidies that is administered by the exchanges.

A decision to change the institutional environment, dimensions of transactions or the instruments of governance structures does not directly effectuate desired results. That is a dynamic process. With regard to the reform, it started with applying the new rules to new entrants. To avoid opposition and circumvention of rules, the Democrats repeatedly emphasized "If you like the coverage you have, you can keep it." (McDonough 2012, 47, 108)

The implementation of the reform is gradually executed over time "in order to allow the public to further prepare for proper compliance with the law in the future." (Shedd and Garvey 2014, 1) Nevertheless, legislative (rulings by judges) and operational challenges (technical problems with the enrollment into plans through the exchanges), administrative complexities, criticisms (employer mandate; birth control) and behaviors (reluctance of doctors to take more Medicaid patients) invoked several administrative, executive and judicial amendments made to Obamacare. (Hartsfield and Turner 2014) Next to this, some citizens may circumvent the rules. Small employers may parry the employer mandate by employing more part-time workers or independent contractors. Insurers may try accounting tricks in order to avoid the norm that sets a limit to administration costs. (Spithoven 2012, 442) Uninsured individuals may try to avoid the tax penalty by claiming a hardship exemption.

Existing criticisms, current lawsuits, circumventing behaviors or unexpected developments might require further adaptations or complementary policies. A complementary policy might be stimulating the rise of well-paid jobs in order to avoid that voters have to stitch together several part-time jobs. This policy might help to convince them that the Democratic party is doing a good job. This might foster more enthusiasm for Obamacare.

Because of the changing party composition of Congress, the Republicans may be able to make small changes to the reform law in 2015 (Roy 2014), but a full repeal is not likely to occur. First, reform achievements, such as credits to small businesses, closing the donut hole, health exchanges, subsidies to individuals, community rating (including the ban on rescission), and the coverage of children on their parents' policies, are broadly embraced (Kaiser Family Foundation 2013). Second, the longer a formal institutional change is on track the more familiar one becomes to the new regime (by shopping around through exchanges) and the less popular a full repeal might become.

Ironically, if the Republican opposition to the reform results in a dysfunctional health care system, they unintendedly may contribute to realize a single-payer or public option. This might be facilitated by the following policies:

- Limiting revenue-raising provisions (lower taxes on medical devices (Roy 2014));
- Withdrawal (by way of the lawsuit *King et al., v. Burwell et al.*) or curtailing individual subsidies;
- Defunding the reform, and;
- A disempowerment of costs lowering provisions such as the Independent Payment Advisory Board (IPAB).

Alternatively, if the Supreme Court makes a strong appeal to lawmakers to decide their conflict in Congress, then this might give the Republicans the opportunity to exchange the challenged health care subsidy provision for limiting the employer mandate (Harwood 2014).

Conclusion

Williamson procrusteanized Commons's approach to governance structures by focusing on efficiency and excluding the struggle for power from the analysis. This resulted in a powerful but biased tool to explain alignment of transactions with governance structures.

Williamson explained alignment of transactions with governance structures by comparing governance costs under the assumption of a given institutional environment, given instruments and given preferences or dimensions of transactions. He ignored power. Its inclusion endogenizes all aforementioned variables.

Decisions to influence relevant variables require piecemeal and temporized enforcement of decided fundamental changes in order to foster a process of learning/bounded socialization, as is shown by the example of Obamacare. Next to this, adaptations are required to unforeseen developments, criticisms and overlooked incidences. Eventually, power is materialized in the form of a change in: mark-up, the institutional environment of governance structures, the instruments of governance structures, or the dimensions of transactions. These changes imply upon their own a change in alignment of transactions with governance structures. In turn, this simultaneously influences not only the power distribution but also the struggle for power which results in further decisions to influence relevant variables. In other words, power is the pivot of the dynamics of social provisioning of goods and services.

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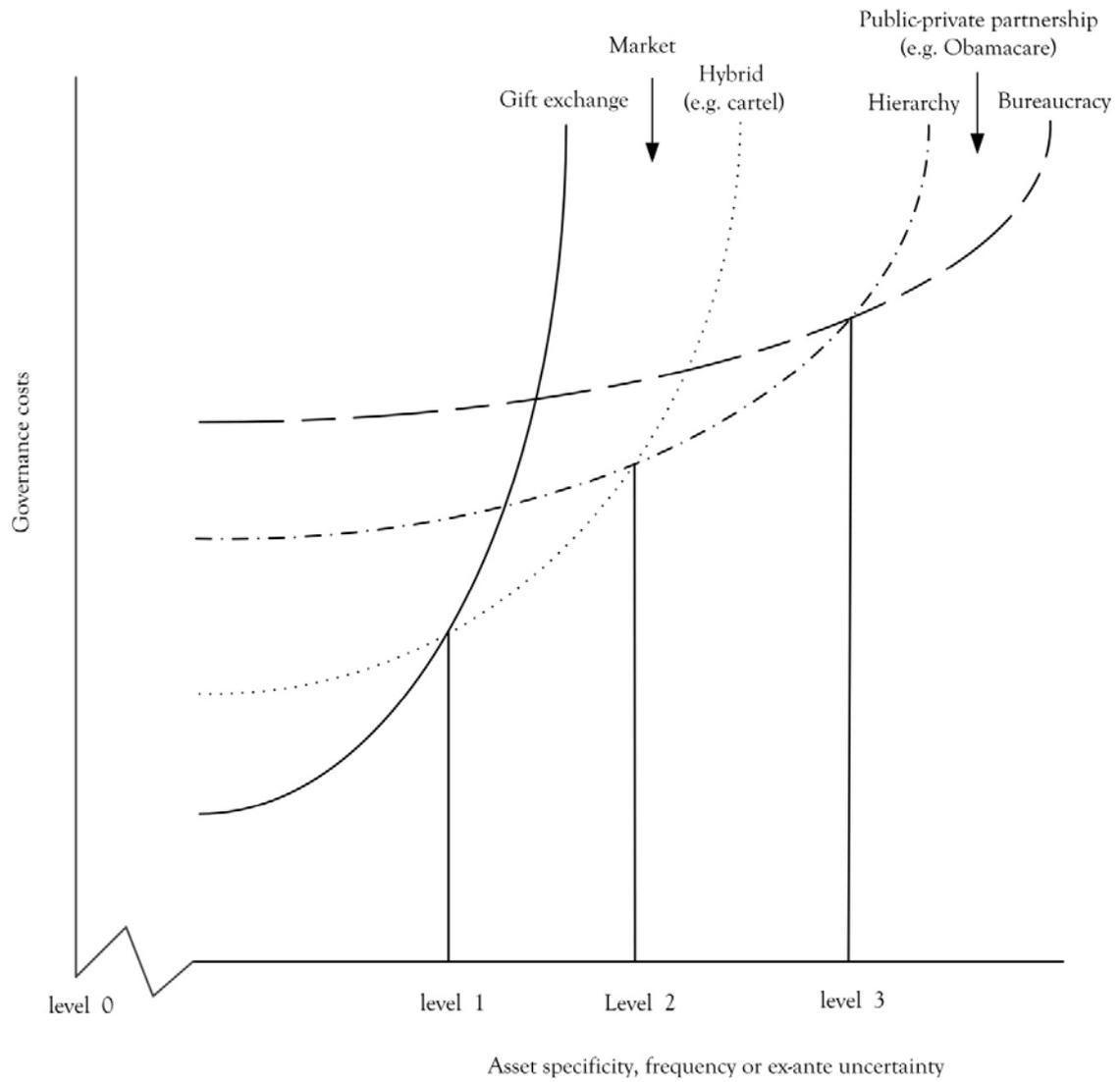
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Figure 1: The complex scheme of governance structures.



Source: Adapted from Spithoven (2012, 434)