

**“For man, when perfected, is the best of animals; but, when separated from law and justice, he is the worst of all.”
Aristotle**

The Problem

We know from history and our everyday experience that there are considerable differences among various human associations in regard to the mode of their interaction: some communities find themselves in a constant state of violence and war, whereas others enjoy almost perfect law and order; some societies have lived and live even today under totalitarianism and tyranny whereas others enjoy a wide spectrum of freedoms and rights; some societies suffer from extreme poverty, some enjoy high standards of living. This list could be continued almost infinitely but the fact is already obvious: human beings, in interacting with one another, can produce highly different circumstances, negative as well as positive. There have been attempts to find a causal explanation for this empirical phenomenon. In a sense, a distinction can be drawn between two different causal interpretations. The older one states that differences occur because all human beings are not alike; some races, ethnicities, nations, etc are by nature civilized and others barbarian. This doctrine did not entirely lose its validity until the mid-20th century, yet it was abandoned once and for all after the Nazis used it to find a justification for the most outrageous crimes against humanity. The other and, in some sense, newer interpretation assumes that all human beings are inherently equal but different circumstances originate from different institutions that exist. In this essay I shall concentrate on the examination of institutions and their role in human societies. The principal argument will be that, like Aristotle contended, human beings can be both “the best of animals” and “the worst of all” dependent on the regulatory institutions (laws, moral norms etc.) that they have.

Definitions

In order to avoid misunderstandings, it is necessary to explain the key terms used in the essay. By *interaction(s)* I mean all contacts, relationships and economic transactions between various people (two or more). *Society* is a group of people connected by a complex network of interactions taking place between them. *Institutions* are entities that regulate interactions between people. Regulatory institutions can be either informal/spontaneous (morals, justice, traditions, social norms) or formal (laws, government regulations).

Why Institutions Arise

The most precise explanations for the origination of institutions proceed from the position of methodological individualism which holds that in order to understand the behavior of a group of people you need to know the motivations of every individual. In other words, every individual, in interacting with others, takes primarily, if not exclusively, his own interests into consideration. In ancient philosophy, methodological individualism was not accepted and, therefore, the interpretation of the origins of social order (institutions) was somewhat vague: Aristotle, for instance, claimed that social order results from the fact that human beings are by nature

social/political animals; yet today, this seems to be insufficient for a complex causal explanation that we are looking for.

Why Institutions Arise: Political Approach

Nowadays there are several individualist doctrines which try to explain why institutions emerge. It is possible to distinct between a political and economic approach. Thomas Hobbes was the first philosopher who provided a theory based on the position of methodological individualism. The conception of Hobbes was followed by that of John Locke, and together, the two form the basis of the political interpretation of the emergence of institutions.

Locke as well as Hobbes use the notion of a state of nature. They basically argue that if there are no authoritative institutions (legal system and government), the social interactions tend to grow violent (because everybody wants to satisfy his/her interests at the expense of others) and that this kind of violence is actually counterproductive to the interests of every individual. Therefore, institutions are necessary to regulate the interactions of individuals. The only difference between Hobbes and Locke is that Hobbes denies the existence of informal institutions: he contends that there is no such thing as justice without a properly enforced legal system. Locke, by contrast, holds that informal institutions like moral norms or what he calls natural rights can exist without formal legal institutions. Although many insist on that difference, the debate on legal positivism versus natural law is not relevant in the current context. What matters is the conclusion that institutions that regulate human interactions are of vital importance because otherwise everybody would suffer from (potential) violence (war of all against all).

Why Institutions Arise: Economic Approach

During the second half of the 20th century, there was a new trend within economics called the new institutional economics as opposed to the predominant neoclassical theory. Institutional economics attempts to provide an economic explanation why institutions arise. The general answer is simple: the lack of a proper institutional framework leads to economic inefficiency and is therefore counterproductive to the interests of every single economic agent (individual). Yet there is a more specific explanation of the reason why economy does not work properly without appropriate institutions; it is derived from game theory.

Game theory is a mathematical method to examine different types of interactions called games; it is used in economics as well as in biology and social sciences. Game theory has demonstrated that although there are some types of interactions (games) in which conflicting interests of individuals can be solved with help of communication and coordination, there are also some games in which communication does not help.

The latter type of interactions is called Prisoner's Dilemmas or rationality traps: everybody acts in his/her interests but the overall outcome is still more negative for everybody than it might have been. A typical example is common resources like fish: every company has an incentive to catch as much fish as possible; yet if every company does this, all the fish are caught so that in the next year there is no more fish at all. The problem is that in this kind of situations communication alone does not

help because even if the companies have an informal agreement to catch only a limited amount of fish, the incentive is even stronger for everybody to exploit more fish at the expense of what others do not catch according to the agreement. The only way out of a rationality trap is binding agreements and/or binding regulations which change the incentives of the individuals. In other words, what is needed is a legal system, and more generally – formal institutions. So the necessity of institutional regulation is inherently characteristic of economic interactions.

The Nature of Institutions

Having discussed the origin of institutions, it is high time now to study some important aspects related to the nature of institutions: the relationship between the reality of social interactions and the regulating institutions, and the process of institutional change.

Numerous empirical examples suggest that the relationship between actual social interactions and the regulatory institutions is a dynamic reciprocal interaction. Karl Marx was right when he claimed that the foundation of society (the economic interactions of people) shape the superstructure of society (i.e. the institutions). Social realities certainly have an impact on how institutions are shaped. For example, technological advances can restructure the economic interactions within a society and thereby have a decisive influence on the legal and political system. This was the case during the Industrial Revolution in Europe. New machines meant new kinds of factories, these factories required labor force that would be free to leave their farms and villages, and so the feudal institutions which did not allow the latter were changed. But Marx was wrong in underestimating the role that institutions can also have on social realities. He failed to see the two categories in dynamic terms and rejected the reciprocal interaction. Yet it should be obvious that institutions have a considerable role to play in shaping the social reality/the interactions between people within a society. An appropriate example is the regulation of economic competition which has a crucial importance in the functioning of the marketplace; without laws that forbid collusion (antitrust laws), the prices could get intolerable for consumers. Also, the wrong institutions in the Soviet Union led to disastrous results in the economy; the introduction of new institutions caused an economic boom in many of the former Soviet republics.

The interpretation of the relationship between social realities and regulatory institutions in dynamic terms implies also that the process of institutional change is an evolutionary one – there are constant changes in both of these spheres and they influence one another. Such dynamic changes result in an overall spontaneous evolutionary process, just as Friedrich August von Hayek argued in his book *Fatal Conceit*. Moreover, it is important to take into consideration that institutions change not only vertically (that is, in a temporal scale) but also horizontally (that is, in a spatial scale). Different societies with different types of institutions influence one another, thereby adding a new factor of institutional change.

Conclusion

In this essay I analyzed the question of institutions in society. I supported the argument that the behavior of human beings in a society depend to a large degree on

the institutions that exist. This explains why in some places at some times human beings can seem “the best of animals” whereas under other institutional circumstances they seem to be “the worst of all”, to use the phrases of Aristotle. Informal institutions like moral and traditional social norms as well as formal institutions such as laws have a considerable impact on how societies work. The necessity of institutions is illustrated by the fact that otherwise, without institutions, societies would collapse politically as well as economically. To achieve a higher standard of living, it is of critical importance to achieve proper and optimal institutions. Yet institutional change is a spontaneous and evolutionary process and therefore it is difficult to make rational reforms quickly and effectively. In constituting a formal framework of institutions, it is necessary to take into consideration the informal institutions like traditions and culture. Although it is often underestimated by economists and politicians, I think that understanding the role of institutions is crucial in order to understand how society works and to make decisions that would meet the realities of the world, and to avoid decisions that could be harmful for the whole society.