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**Universiteit Utrecht**

**Utrecht School  
of Economics**

**Tjalling C. Koopmans Research Institute  
Utrecht School of Economics  
Utrecht University**

Janskerkhof 12  
3512 BL Utrecht  
The Netherlands  
telephone +31 30 253 9800  
fax +31 30 253 7373  
website [www.koopmansinstitute.uu.nl](http://www.koopmansinstitute.uu.nl)

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ontwerp voorblad: WRIK Utrecht

**How to reach the authors**

*Please direct all correspondence to the first author.*

Piet Keizer  
Utrecht University  
Utrecht School of Economics  
Janskerkhof 12  
3512 BL Utrecht  
The Netherlands.  
E-mail: [p.keizer@econ.uu.nl](mailto:p.keizer@econ.uu.nl)

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# The Concept of Institution: Context and Meaning

Piet Keizer

Utrecht School of Economics  
Utrecht University

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## Abstract

When trying to understand what is meant by the concept of institution we must analyse the context in which institutions are assumed to play their role. In a typical economic analysis institutions are rules that serve the interests of economic-rational actors, and must enhance the efficiency of their actions. In a typical sociological analysis institutions are rules that serve the interests of social actors, and must enhance the formation of stable systems of hierarchically ranked groups. In the real world human behaviour also has a psychic aspect. In a typical psychological analysis institutions must promote the integration of different parts of a personality. This article assumes that in real life humans are driven by a composite of three categories of forces, namely the economic, the social and the psychic motive. Real life institutions have the function to mould these drives in such a way that economic, social and psychic goals can be reached more effectively. As a matter of illustration of this moulding process a short sketch of the emergence of the Dutch welfare state is given.

**Keywords:** economic, sociological, psychological, institution, welfare state

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## **1. Introduction**

The meaning of the concept of ‘institution’ is a hot topic in various disciplines. Generally speaking institutions refer to man-made rules that govern human behaviour.<sup>2</sup> An increasing number of economists agree that “institutions matter” when explaining economic performance. In sociology the concept of ‘institution’ has always been at the centre of analysis. When comparing the concept as used in different disciplines, we notice that their meaning differs significantly.

When searching for the meaning of a concept we first have to develop an appropriate analysis of the situation in which the phenomenon that must be analysed plays a role. It means that we must develop an effective instrument that explains human behaviour in this respect. Then we understand why humans develop institutions, or accept institutions as they are - intended or unintended. Explanation of human behaviour implies the search for causes. We can distinguish between immediate causes and ultimate causes. In orthodox economics, for instance, humans are assumed to be economic-rational actors. In other words, they are supposed to be economically motivated, or in other words, be driven by an economic force, in an environment that consists of scarce goods. This force is conceptualised and modelled as the drive to maximise utilities under the constraint of scarce resources. If a price of an important scarce good changes an economic-rational actor is inclined to change his quantity demanded or his quantity supplied. In this case the change in behaviour can be explained in two ways: the immediate cause is the price change, and the ultimate cause is the economic force. The price change is the incentive for humans to change their behaviour. But without economic force the price change is not an incentive. Orthodox economics has isolated the analysis of the economic force from the other forces that set people in motion. When analysing institutions in a realistic way we have to add an analysis of these other forces to our typical economic analysis. So, if we want to conceptualise and explain why institutions develop and persist, we need a sophisticated analysis of the behaviour of the people who develop these institutions. Only then we have an analysis of the context in which institutions have meaning and can function properly.

The setup of the paper will be as follows. In section 2 we deal with the ontological characteristics of the world to be analysed. In section 3 we derive a meaningful concept of institution from it. In section 4 we develop a series of different worlds in which institutions are assumed to play their role. We will compare economic, psychic, social, political and moral aspects, which play their part in the analysis. Section 5 discusses the evolution of the Dutch welfare state, so as to illustrate what we mean by an integrated analysis of institutions. Section 6 concludes.

## **2. Analysis of the Context of Institutions**

Science aims at a systematic analysis of the universe. When explaining human behaviour it makes sense to distinguish between human and non-human elements of the universal system. From an existential point of view human life is characterised by uncertainty. Without a reliable interpretation of the situation humans are paralysed by existential fear. Fortunately humans are equipped with reason, which is the capacity to frame the situation in particular ways, and to judge situations in terms of opportunities to live a life of their own. Besides reason the mind harbours bundles of emotions. These emotions are forces that set people in motion.

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<sup>2</sup> See for a more extensive treatment of the institutions literature: Keizer (2007b)

When making a distinction between the mind and the body of a human person, we can interpret the mind as his internal world, while the body can be interpreted as part of his external or empirical world. Humans are able to become aware of the internal world by means of introspection. Sense impressions make us aware of the existence of the external world. Introspection has led to the discovery of series of principal needs that set people in motion to get them satisfied. It also led to the discovery of the capacity to frame the world, not only the empirical, but also the internal world. In this way we achieve meaningful knowledge, which can be interpreted and understood, and used to our own advantage.

The experience of needs and the satisfaction of them – is a characteristic of the internal world. Neither needs nor satisfaction can be observed empirically. But the (empirical) circumstances play a crucial role in the satisfaction of needs. The world ‘out there’ offers necessary inputs to produce the satisfaction. The external world, including the human body, also exists of many ‘systems’ with their own needs. It is necessary to satisfy these needs in order to continue using these systems to reach satisfaction of the human person taken as a whole.

When explaining human behaviour we can make a distinction between three primary interrelationships (Keizer 2007a). In the first place, the interrelationship between humans and non-humans, which is characterised by the human drive to use these non-human objects to satisfy particular needs as much as possible. In the second place, we distinguish the interrelationship between humans, which is characterised by the drive of humans to use each other to satisfy the need for social recognition as much as possible. In the third place, the interrelationship between a human person with their self, which is characterised by the drive of human persons to satisfy the need to self-esteem. Every unit of human behaviour has these three aspects. The first interrelationship is about the economic aspect and the drive involved is the so-called *economic motivation or force*. We use, for instance, wood, metal, fruits, houses, computers, cloths and many other non-human objects to satisfy a series of typical economic needs, such as warmth, safety, shelter, knowledge, and a well-fed body. The second interrelationship is about the social aspect and the drive involved is the so-called *social motivation or force*. It drives us to maximise our status in the eyes of socially relevant others. On the global level the USA, China and Russia are actors who are heavily involved in a status battle. In every firm there are ongoing status battles between different departments and groups of professionals. At universities gamma and alpha sciences recognise that beta has the highest status in the Western world at the moment. Barcelona and Real Madrid are involved in a rivalry of a social nature that is different from economic competition. Many resources are spent in these social rather than economic games. The third interrelationship is about the psychic aspect and the human drive involved is the *psychic motivation or force*. It drives us to maximise the status of the self in our own eyes. Persons who are perfectly rational have complete control of their emotions. By means of will-power humans can force their selves and behave rationally. They have maximised their self-respect by minimising the difference between their true self and their actual self under the restriction of the strength of will-power. In practice not any person is perfectly rational, of course. We are all limited in terms of will-power, which means that our reason is unable to perfectly control our emotions. Therefore we must accept that our behaviour differs from what we know of what is good for our selves. Many people are addicted to particular life styles and have overdoses of drugs, alcohol and power. In

the business literature the imperfect rationality of many business leaders is stressed, which has far-reaching consequences for the decisions they take (Kets de Vries 2006). Of course, not only business leaders are subject to addiction. Many men in masculine cultures are addicted to privileges that are legitimised by their culture. Since many practices are very cruel and not reasonable, these men may have serious psychic problems in the end.

So it is normal for humans to have economic, social and psychic problems. We are permanently driven to solve these problems. In every act or move the three categories of drives are involved. The solution to economic problems is limited by *technical constraints*. Non-human objects are interrelated in particular ways. We call these relationships ‘technical’. We can think of physical and chemical relationships between atoms and between molecules. Physicists analyse natural phenomena such as gravitational force, magnetic fields, light and sound, and electricity. Chemists analyse organic and an-organic molecules and the conditions under which they cluster together. More knowledge about these natural processes – also within the human body – implies more control of these processes, and increased possibilities to use these processes to our advantage. By investing in human capital technological progress implies an ongoing improvement of the performance, if other limitations do not exist. In reality, other limitations do exist, however. The social force to maximise status is always at the cost of the status of the other. Therefore this problem cannot be solved by a general increase in resources. We can only try to limit the economic, social and psychic costs of the ongoing status battles by developing rules of the status game. For instance, the French and the Germans were involved in status battles for centuries. After the Second World War both sides were willing to abstain from military solutions. By cooperating in the production of coal and steel they made it difficult for themselves to fall back on military strategies: the ‘reason why’ of the European Union is to minimise the costs of the social battles. The institutions aim at the toning down of the social force and the stimulation of the economic force by the creation of a common market. In general we can say that *moral rules*, whether or not in the form of legislation, aim at the restriction and regulation of status battles. By investing in moral capital more room is created for ongoing economic progress. Also our third drive, the psychic force, is limited. We are driven by different sorts of emotions and it is not clear at all whether the immediate satisfaction of them serves the long term interests of person and society. Our reason must sort out which emotions serve that interest, and which emotions do not. After having done this job the person knows his long term interest, but must develop the will-power to act accordingly. *Limited will-power* is another restriction to the relationship between technological progress and economic performance. By investing in mental capital more room is created for ongoing economic improvement is created.

In the following section we will discuss the implications of this analysis for the conceptualisation of ‘institutions’.

### **3. What is the Meaning of the Concept of Institution?**

As said in the previous section essentially people are very uncertain about their condition. To avoid existential fear they are driven to develop an idea about the situation. Therefore they frame their internal and external world in such a way that it becomes more understandable. Simple maps help us to decide what to do to improve

the situation. In section 2 we sketched an outline of a first framing already. Other first framing is thinkable of course.

Every interpretation of reality starts with an idea. If a person adopts an idea about his situation he is able to frame it, and makes it more understandable. Then it becomes clear how the person is related to his environment, and what he has to do to improve his situation. If a group adopts an idea about their identity they are able to frame their situation in such a way that it becomes clear how the group is related towards their environment, and what to do to improve their situation. Every person is driven by a composite of forces of particular strengths. Moulding of these forces means that the relative and absolute strengths of these forces change in such a way that long term interests of persons and groups are served. Framing of the external and internal world makes it possible for persons and groups to act rationally and socially. Will-power and morality affects the degree to which people really act accordingly.

The general and common understandings developed by persons and by groups – i.e. *culture* – are the basis for the design of frameworks of more specific rules that govern human behaviour. These are called *institutions*. Various persons and groups develop different institutions. Families, businesses, government agencies and churches, for instance, all have their own institutions. In real life cultural systems and institutional frameworks are not perfectly consistent with each other. Some sectors or sub-sectors appear quite dysfunctional. In the long run societies cannot afford to have large sectors that are dysfunctional. It would lead to disintegration. So with persons: if the personal system consists of different aspect- or subsystems that are not consistent with each other, the person tends to become disintegrated. Disintegrating societies and persons become increasingly violent, since various basic needs cannot be satisfied anymore. In other words, a coherent cultural system, which is consistent with a coherent institutional framework, is a necessary condition for persons and groups to effectively satisfy their basic needs.

Now we have formulated the function of institutions. *In an interactive process between individual and group institutions are developed that mould human motivations and channel human actions in such a way that basic needs can be satisfied more efficiently.*

Generally formulated maps, goals and strategies give rise to the development of rules of different kind. They can be formal or informal, and they can be written down or known by stories told. People can be aware of them, or unaware. In case of unawareness we call it tacit knowledge or the individual and collective unconscious.

In real life there are many cultures to be distinguished. A principal distinction is that between more *traditional* and more *modern* cultures, or more *conservative* versus more *progressive* cultures. Traditional cultures offer quite hierarchical frameworks to deal with the problem of uncertainty. Gods rule the world. There are elites that rule societies on their behalf. Nobility rules the gentry, etc. In this way societies are very stratified. For everyone there is a position in the social structure, and if nobody resists the social problem of human rivalry has been solved. Then energy can be saved to solve the psychic and the economic problem. In more modern societies everyone is assumed to be free and responsible for their own and each other's well-being. Individuals must be taught to solve their own economic, psychic and social problem,

and in this culture institutional frameworks must be developed to make it possible for individuals to bear responsibility for their selves. If the culture is traditional and the institutions are not hierarchical and well-stratified, problems cannot be solved adequately. And so with progressive societies: free and responsible people cannot solve their problems in hierarchical institutional frameworks.

Rules that constitute institutional frameworks affect human behaviour. Otherwise they are not really institutionalised. There are two mechanisms along which we can make rules more effective. The first mechanism uses the phenomenon of *morality*. People have the capacity to understand what is morality (practical reason) and they have the capacity to feel when a situation is morally relevant (moral sentiment or moral resentment). So if rules are institutionalised deviation from these rules create moral arousal, which implies dissatisfaction. The negative utilities that result from deviant behaviour are an incentive to stick to the institutionalised rules. A second mechanism uses the phenomenon of *polity*. Every system has a subsystem that is responsible for the control of the typical processes that constitute the system. This control system or polity must be institutionalised in such a way that the system does not deviate too much from its optimal strategy. A person is equipped with the capacity to judge, and can therefore decide to avoid too much deviation. A firm has a board, which is responsible for the formulation and application of optimal strategies. Societies have a government who is responsible for an effective institutional framework. If the government fails to avoid too much deviation, democratically organised societies trust people to vote for better politicians. Governments from hierarchically organised societies do not ask people for their opinion, since the masses are supposed to be ignorant. They are assumed to develop their own control mechanisms.

In the following section we will discuss a series of worlds in which institutions are supposed to fulfil particular roles. Then we can illustrate why – within social science – different interpretations of the concept of institution are rivalling with each other, and why these rivalries can be conquered.

#### **4. Different Worlds Mean Different Institutions**

According to Adam Smith culture matters when explaining and fostering economic growth. In his *Theory of Moral Sentiments* (Smith 1759) he analyses what it means for persons to be rational and social. These are the necessary institutional conditions for a well-functioning system of free markets, as analysed in his *Wealth of Nations* (Smith 1776). According to Marx culture doesn't matter (Marx 1883). The institutions are determined by the interests of those who are economically powerful.

In a later stage of development economics became increasingly institution-free. The research methodology of orthodox economics implies the construction of a world in which the operation of the economic force is isolated from the operation of the other forces that can be distinguished. Implicit assumption is the presence of a government who is perfectly able to protect private property rights. Actors are explicitly assumed to be economic and rational. Under these conditions free markets lead to an optimal allocation of scarce resources.

In the period that economics increasingly disregarded institutions other social scientists – sociologists, in particular – put institutions at the centre of their analysis (Durkheim 1899, Weber 1922). Economies and other sectors of society can only function well if there are institutions that hold society together. Actors are assumed to

be social beings. They operate group-wise, and are supposed to serve the group interest. Different approaches in sociology gave rise to different views on which institutions are desirable. Whereas orthodox economics is explicit about a constant economic force that drives human individuals, was classical sociology less explicit in this respect. Here the motivation is not exogenous and constant, but determined by historical trends in societal structure. After the Second World War an increasing number of sociologists paid attention to the issue of the human nature, thereby referring to the founding fathers of psychology (James 1890, Cooley 1902). These micro-sociologists try to explain societal development by means of social processes that take place on the level of a small group (Mead 1934). Social innovation starts in some families or businesses or in non-governmental agencies. If new institutions are attractive for other groups they imitate these social novelties. In this way society as a whole may be infected with this idea.

The problem with orthodox economics is the fact that it assumes a constant, economic and rational human nature. The problem with sociology is the fact that – in most analyses at least – it is not explicit about the different forces that drive humans in their actions. Most of the time it is unclear what is the meaning of the term ‘social’. In both sciences psychic problems are hardly analysed. Implicitly or explicitly perfect rationality – which is not the same as perfect information – is assumed. To offer an integrated analysis of the functioning of institutions we first sketch the worlds in which the three primary forces are operating in isolation. This orthodox economic research strategy has led to analytical rigour, more than in most other parts of the social sciences. Besides the economic world, as developed by orthodox economics, we will sketch a social world and a psychic world. In order to function well these worlds need to be institutionalised in particular ways. After the sketch of these worlds we will show in which way the three worlds can be integrated.

### **The economic world**

In the economic world all action is economic in nature, which means that people are economically motivated. The omni-present problem of scarcity is the only problem they have. Scarcity is defined as the ratio between the needs of the actors and the resources available to satisfy these needs. All actors are motivated to minimise this ratio as much as possible. So the first axiom of the economic world says that actors are *economic actors*.

To analytically isolate this motivation or drive from the operation of the social force, we assume that there are no social relationships. So, if I enter a shop, the shop keeper is just a scarce resource for me, not a human being, including a set of inalienable rights and duties. If there had not been any shopkeeper, but just a vendor machine, it would not have made any difference to me. It implies, for instance, that I do not care about the question whether the shopkeeper is male or female, black or white. There is no social distinction; neither rivalry between different religious or ethnic groups, nor solidarity between employed and unemployed, young and old, healthy and sick or handicapped people. Every actor is an independent individual without any social right or duty. So the second axiom of the economic world says that actors are *asocial actors*.

To isolate the economic force from the operation of the psychic force, we assume that actors are perfectly rational. It means that human behaviour is based on deliberately

collected information about costs and benefits of every possible strategy. Emotions are not playing any role when taking decisions. They only play a role when establishing what is desired and preferred. For example, if your beloved grandmother gave you a watch, it has much value to you. The emotion – the memory to your grandmother – makes the watch to a very valuable object for you. A rational approach to this problem would be as follows: first establish the value that you attach to the watch. Assume that this value of use is 10,000 euros. If another person is offering you 10,001 euros, it is rational for you to sell the watch to that person. If the price that is offered is lower than 10,000 euros, it is not rational to sell. An example of an emotional action is the following: you are shopping and suddenly you see a pair of very nice shoes; the size appears exactly the right one. You decide to immediately buy it, without even asking for the price; you simply use your pin card. This is not a rational, but an emotional action. There is just the emotion of desire, without any deliberate weighing of costs and benefits. So a third axiom says that actors are *perfectly rational actors*. A fourth axiom says that *classical logic can be applied* without any problem.<sup>3</sup>

As explicated the economic world consists of economic, asocial, rational actors. They are not only inclined to produce and consume goods. They also develop rules for their selves and for the aggregate of actors. For instance, habits and routines are developed to economise on the use of scarce resources. Once a particular *life style* has been developed that fits the long term goals of the actor it is too costly to constantly consider different styles to see whether they are more efficient. In case of market failures it is efficient to develop a system of public governance, which adopts legislation that enhances the economic efficiency. In case of externalities, for instance, it is efficient to adopt rules to avoid prisoner's dilemmas. So the economic world is characterized by **economically motivated institutions**. Remind that social relationships do not exist, which means that there is no culture. It means that there is no morally motivated control system. The political control system is the only one in operation. So only if persons really want to behave in particular ways, they accept their own rules and are inclined to adjust to the rules in case of deviation. Public rules can only be controlled by policing agents. They are allowed to punish those who breach the rules. Bribery is a natural phenomenon in the economic world, since policing agents are economic and rational and don't have feelings of guilt in that case.

#### **The social world<sup>4</sup>**

The idea of constructing a world that represents just one aspect of human behaviour is not as popular in sociology as it is in economics. Of course, all theory is based on an analysis that is developed upon the basis of a particular perspective. Perspectives never reflect all aspects of a particular phenomenon (Popper 1957). Actually, sociological theory has a 'social' character. Fortunately, there are a number of famous sociologists who discussed the social aspect as one of the aspects to be studied by sociology explicitly (Parsons 1978). Later Homans composed small groups of people to see what the members would do in various circumstances (Homans 1961).<sup>5</sup> In order

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<sup>3</sup> In this context it is not relevant to elaborate on this axiom. See for a more detailed explanation: Keizer (2007).

<sup>4</sup> See for a more extensive exposition of the social world: Keizer (2005).

<sup>5</sup> The so-called Homans' Law says that a small number of people who have regularly face-to-face contact and perceive each other as equals develop a common culture. Kidder reports an experiment done with astronauts in long-distance flights: systematic recording of the trainee behaviour showed that

to complement the economic logic with an analysis that represents the social logic we will develop an analysis with a structure that is highly comparable with the typical economic analysis (Keizer 2005).

Our social world can be characterised by a number of axioms. The first is the ontological statement that *humans are social beings*. This means that relations between people are of a social character.<sup>6</sup> The term ‘social’ means that humans recognize each other as members of the human race, which has implications in terms of rights and duties towards each other. A logical implication of being social is the propensity of individuals to group together. A number of individuals are a group in the social sense of the word, if they share a common culture. Culture refers to the framework of interpretation or worldview of the group. It includes a set of values and norms. A society is characterized by a particular social structure, which means a ranking of groups according to the status they have towards each other.

So far we have presented a picture of the social world that is logically derived from the axiom that humans are social beings. This picture shows the social situation. Now we can state, on the basis of introspection, that (groups of) people are driven by the *desire to maximize their status*. Individuals do this by showing a maximum of loyalty to the group; it means a maximum of adherence to group views, values and norms. It also means that people are inclined to work on an improvement of the social performance of the own group, expressed in terms of status, which refers to the position of the group in the (hierarchical) ranking. So the individual status is completely dependent on the group status, which is maximized by these individuals by means of various sorts of actions. These actions have in common that they must show the superiority of the own group (‘us’) towards the other group (‘them’). A necessary condition for showing this superiority is the complete adherence to the own culture. The statement that individuals are driven to maximize status under the constraint of the own cultural rules reflects the meaning of the idea that humans are social actors.

In order to isolate the social force from other forces, we must assume that *there is no scarcity* in the social world. Everyone possesses an amount of natural resources that is enough to satisfy all the needs. This is the axiom of *complete satiation*, implying that all economic problems are solved. Of course there is a social restriction: even if we were to spend almost all resources available to reach a higher status, we might still fail, since our rivals may be smarter in this respect. Another axiom is needed in order to ignore psychic problems. So we assume *humans in the social world to be perfectly rational*: well-informed about the different cultures and status producing techniques or deliberately search for information about these matters. A last axiom is the assumption that *classical logic applies*, completely in line with the economic world. The four axioms just described constitute the so-called social world. It is, by definition, a world that is ruled by social logic. The two worlds differ ontologically:

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an unspoken body of rules developed during their confinement. Modern experiments also show the empirical relevance of this law: see De Cremer, D. and Van Vlugt, M. (1999). It would be interesting to see whether Internet contacts also lead to the development of cultures, although the conditions might not meet the criteria set by Homans.

<sup>6</sup> It means that we are focusing on the social rather than on the economic aspect of the relationship between people.

humans are seen either as economic actors or as social actors. But they agree with respect to the rationality and the logical aspect of the two worlds.

Social actors are in need of rules, so as to minimize the costs of the status battle. As long as we assume complete satiation, which means that natural resources are not scarce, the costs are only expressed in terms of humiliation. The way male and female American soldiers treated male Iraqi prisoners – like dogs – is a good example in this respect. In general it creates strong feelings of superiority with the dominant party, and strong feelings of frustration and resentments with the dominated party. The latter party searches for revenge, which makes the status battle to an ever continuing affair (*panta rei*). If the fighting groups are reasonable, they are inclined to develop rules that lay a lower limit to the degree of humiliation. In the first place, reasonable people admit that we are all human, and in that sense we are equal, and deserve equal respect. Secondly, we are risk averters who recognize that a moment may come that we are the subordinated party, and then benefit from a culture that has maximized the lowest level of humiliation (*maximin principle*). Western civilisation is highly influenced by this idea of human equality, as is illustrated by the UN Charter about Human Rights is a good example. These rules are **socially motivated institutions** that function as constraints of the status battle.

### The psychic world <sup>7</sup>

We will construct a psychic world that is quite similar in structure compared with the economic and the social world. When analyzing the mind, we cannot consider the human person as an individual anymore. ‘Individual’ means a unit that cannot be divided. But analysis means a distinction between different parts of a whole. These parts may have their own drives and aim at the achievement of their own goals. Now we imagine that there are multiple ‘selves’, who live in one and the same person.<sup>8</sup> Let’s call these parts ‘sub-selves’. In what respect do these sub-selves differ from each other? We must be aware that the psychic world is surrounded by the economic and the social world, where all psychic problems are assumed to be solved. The person is completely free to determine his preferences, without being confronted with economic and social constraints. Now we distinguish between various selves on the basis of the different tastes they have. A human person that has solved the economic problem of scarcity and the social problem of status will thereby enjoy different

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<sup>7</sup> Since we want to analyze the psyche, we are interested in the analyses from psycho-analysts. Other parts of psychology are not searching for the logic of the psyche. Most parts of psychology search for empirical regularities in the behaviour of persons. In the prestigious economics journals is growing attention is paid to the role of psychic factors; see for instance Rabin (1998), Elster (1998) and Tirole (2002). Unfortunately, no analyses on the *ontological* level are presented so far. In our research strategy we first need to formulate a psychic world. Thereafter, we look for an analysis and the establishment of correlations between properties of a person and properties of his or her environment. There are three famous psycho-analysts, namely Freud, Jung and Adler. Freud adopts the typical biological view on the functioning of the psyche, Adler adheres to the typical social view and Jung can be considered, in our interpretation at least, as the orthodox psychologist: he analyses the functioning of the psyche itself and did much on its ontology. So Jung is very important for our goal. If we want to integrate the psychic world with the social world we can use Adler. If we want to connect the psychic world with the biological world (the body), Freud may be important, although modern neuro-science has a lot to say about the body-mind problem too.

<sup>8</sup> See Richard Stevens (1996) for an overview of the psycho-dynamic approach. See Anthony Stevens (1994) for an exposition of the approach by Carl Jung. He makes a distinction between ‘I’ and ‘self’ and a distinction between different selves. Margolis (1985) uses the idea of multiple selves already, to explain phenomena like selfishness and altruism.

aspects of life. Since the sub-selves are entities that are driven to satisfy particular needs, the result of all these forces drives a person towards a particular appreciation, under the time constraint<sup>9</sup>.

Now we make a distinction between the 'I' of a person and his 'self'. The self consists of many independent *sub-selves*. These sub-selves compete with each other in their attempt to determine the behaviour of the person. The 'I', however, can be interpreted as a decision making centre; it formulates an ambition with respect to the self. This ambition can be called the *true self* or the soul of the person. If the person appears to be able to achieve his ambition, the person has maximized his respect for the self, his *self-respect*. In the psychic world, which is isolated from the economic and the social world, the 'I' has no economic and social problems. So, it must only control the different forces in such a way, that the person maximizes his total of psychic utilities. As soon as we integrate this psychic world with the economic and the social world, minimization of scarcity and maximization of status become important inputs in the production function of 'self-respect'.

We have stated that there is a constant tension between the ambitions of the 'I' and the identity of the own self. In other words, *the nature of a psychic problem is the tension between the desired and the actual identity of the 'self' in the eyes of the judging 'I'*. Suppose there are two sub-selves. Sub-self 1 is a force with a voice saying that life must be lived according to a set of standards A. Sub-self 2 is a force with a voice, saying that life must be lived according to a set of standards B. Sometimes the 'I' takes decisions according to the tastes of self 1, but then self 2 is dissatisfied, which makes the 'I' unhappy. Then the 'I' takes decisions according to the tastes of self 2, but then self 1 is dissatisfied, which makes the 'I' unhappy. The result is a low status (respect) of the self (composite of sub-self 1 and sub-self 2) in the eyes of the 'I'. In this psychic world *the 'I' tries to integrate the different sub-selves in such a way that the difference between the desired identity and the actual identity is minimized*. Then the status or respect of the self in the eyes of the judging 'I' is maximized. In other words, human beings maximize their self-respect. Lack of integration between the different sub-selves and between the sub-selves and the 'I' create disutilities. A perfectly integrated person has, by definition, maximized his self-respect.

A last question must be answered now. Does the 'I' have the power to keep some control over the (emotive) forces? We assume that it has and we call it *will-power*. If the 'I' considers his power as too weak, it can increase it by letting the mind do exercises. So a mental force is trained to support the will in his battle against different sub-selves. Now, our picture of the psychic world is complete: the 'I' maximizes self-respect under the constraint of the strength of its will-power.

We have constructed a psychic world that consists of several 'selves' and an 'I' that tries to minimize the differences between the different 'selves' in such a way that the respect of the 'I' for the self is maximized. This psychic motive drives the 'I' to do this job. This ontological statement is the basic axiom that makes the world a typical

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<sup>9</sup> If we would not assume a time constraint, a person who has solved his social and economic problems can simply satisfy all needs and has no psychic problem either. The existence of time already is a problem, since everyone must establish a time preference. This is a problem for persons who are less than perfectly rational, since many strong emotions force the person to immediately satisfy many needs at the same time; he must choose!

psychic world. Internal tensions make a person unhappy and the 'I' tries to solve this tension by using its will-power. If the 'I' has solved the typical psychic problem completely, the actor has a perfectly integrated identity or personality. He knows exactly who he is and what he wants, he will deliberately search for information that serves his goal of utility maximization.<sup>10</sup> Then the person is perfectly rational, as is assumed in the economic as well as in the social world, if he has enough will-power to act accordingly. Emotions only play a role in the determination of the true self. But all the instruments used to reach the state of true self are rationally chosen.

Imagine a person is very wealthy, physically healthy, and well-educated. Imagine that this person has many family members and many friends, and colleagues, and is highly appreciated by his relevant others. There may one problem being left: his psychic problem. His control of the emotions connected to immediate desires is imperfect, which makes his respect for the self relatively low. This produces flows of psychic disutilities, making our person unhappy. Now it is necessary for him to strengthen his will-power so as to increase control of his passions. On the basis of a particular understanding of the situation – including a particular identity of the person and a particular frame of the situation - as offered by the true self, he develops a set of rules that must lead to an increase of will-power. For instance, every morning our person takes a cold shower, and a healthy breakfast. Then he forces himself to study three hours without interruption. Then he allows himself to do something he likes very much, etc. By strongly institutionalising his life, he hopes to gain control of his life, in such a way that his self respect is increasing. By setting tough goals, and reaching them, psychic problems can be solved. In extreme cases psychic problems can lead to disintegration of the personality – like social problems can lead to disintegration of society. If the 'I', advised by the true self, takes the actual selves seriously, and discovers their addictive and uncontrollable nature, training in control may have significant effects. **Psychically motivated institutions** aim at an increase in the degree of rationality of individuals.

### **The real world**

We will never be able to explain and describe the real world. Our knowledge is about the picture or map of the real world we have in mind. However, if we construct a map on the basis of the idea that human actions are driven by the composite of three primary forces, rather than assuming just one, constant force the map will definitely be more realistic. In Keizer (2007 (b)) such an integrated map is constructed and analysed. Humans are driven to maximize utilities from the consumption of natural resources (economic force – E), to maximize the status they derive from their social position (social force – S), and to maximize their self-respect from the way they live their life (psychic force – P). We call the world that is analysed this way the PES-world. Methodological individualists consider these drives as the exogenous factors that explain human behaviour. In orthodox economics it is the constant economic force that explains why actors change their behaviour in case of a price change, for instance. But methodological collectivists explain human behaviour from the historical trends that are responsible for the evolution of societies at large. In this approach human nature is endogenous. It changes under the influence of societal trends. Both methodological approaches can use our model of human nature to show

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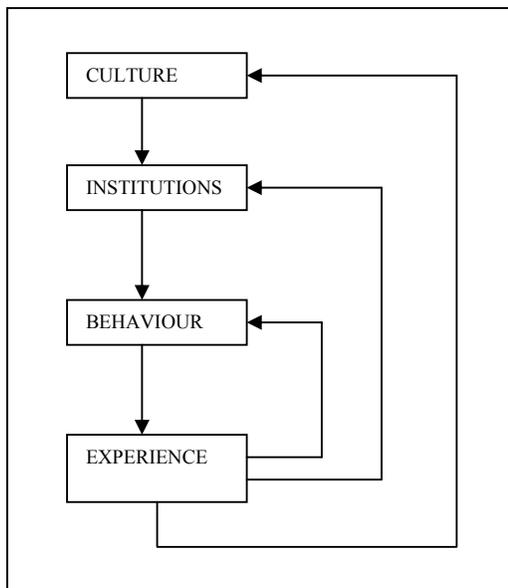
<sup>10</sup> Both the economic and the social world assume actors to be rational. It implies that they have solved their psychic problems completely. In other words, these worlds assume perfectly integrated persons.

their interpretation of causality. In a more sophisticated methodology an interaction between the micro and the macro level is constructed. Then societal characteristics affect the composite of drives and their relative strengths, which determine individual and aggregate behaviour.

In this PES-world people are inclined to develop **PES-motivated institutions**. Real world institutions are meant to frame reality and to mould the drives of the people in such a way that psychic, economic and social goals are reached more effectively. In a world without institutions uncertainty creates existential fear and an unpredictable and possibly violent way of satisfying immediate desires. Institutions make the world simpler and people more rational and social.

Rules to reach ultimate goals more effectively can only be developed if people know what their ultimate goals are. But goals can only be established in connection with ideas about how to interpret the world. So institutions can only be developed in a *cultural context*. Within this cultural-institutional setting people live their daily lives, have their experiences and adjust their behaviour if their experiences are different from what they expected. So the following scheme can be presented reflecting the relationship between culture, institutions, behaviour and experience.

Figure 1 Cultural and Institutional Change



There are three feedbacks to be distinguished. If experiences are different from what was expected, other options are considered and tried. For instance, a person is used to drink 20 glasses of beer every evening. To an increasing extent the person feels bad the following morning. Now she can decide to reduce the number of glasses per evening to 10, and spend her remaining resources in a more healthy reaction.

Unfortunately most people are far from perfectly rational. When drinking lack of will-power leads to drinking too much, every evening. After a while our person can decide to adopt a rule, saying to herself: don't go to the bar every evening. Moreover, if there are many people in society stimulating each other in drinking too much – drinking much beer as a status thing - , associations of people or even the government can develop anti-alcoholism policies: frameworks of rules that must discourage behaviour

that prevent people from serving their own long term interests. By accepting the rules and applying them in daily life, people are changing their motivational structure. The development of these institutions can only be successful, if they are embedded in a culture that supports the ideas behind these institutions. If not, the experience of people can trigger cultural innovation and change, which concerns the way people frame their world, and formulate their ultimate goals. The first feedback is the easiest and the third feedback is the most difficult one to realise. We have presented this scheme in figure 1. In the next section we will illustrate how this analytical framework can be used to better understand the evolution of the Dutch welfare state.

## **5. The Dutch Welfare State**

### **Introduction**

In this section we interpret the evolution of the Dutch welfare state in terms of our PES-approach. In this way we hope to illustrate how this approach could work, more than give an extensive analysis and explanation of this phenomenon. In our analysis the concepts ‘economic’, ‘rational’, and ‘social’ are at the centre. All actors are assumed to be economic, but some actors have a stronger economic motivation or force than others. All actors are assumed to be imperfectly rational, but some actors are more rational than others. And finally all actors are assumed to be social, but some actors are more social than others. If actors would be perfectly social, they have completely accepted the rules set by the prevailing culture and institutions. It implies the acceptance of the actual ranking of groups. Imperfectly social groups are in conflict with each other, and try to change the ranking in order to gain status.

If we analyse a world of imperfectly rational and imperfectly social actors (individuals as well as groups), the two properties – rational and social – affect each other. Rational actors are driven to serve the long term interests of their selves. Social actors are driven to serve the interests of the group in relation to other relevant groups. In combination it leads to the conclusion that actors who are rational and social are driven to serve the common long term interests of society as a whole.

However, the views of the different actors are highly influenced by the position they take in society. It means that there may be a conflict with respect to the specification of the common long term interest. Actors living in a particular area meet each other on a regular basis. In this way they are inclined to develop a common understanding of their situation, including the formulation of a few ultimate goals. The culture that emerges forms the basis for the development of institutions that aim at the promotion of societal long term interests. Within the context of a generally accepted culture institution formation is a process of give and take. We will show that the Dutch welfare state is the result of a slow but ongoing process of bargaining within the cultural constraints. The result is a generally accepted institution called welfare state that has appeared quite sustainable.

### **A Very Concise History of West European Culture**

More than two thousand years ago West European culture was quite primitive. A strong hierarchical societal structure tried to make people more rational and more social. Then Greek-Jewish-Christian views and values increasingly influenced West European societies. For our purpose we can formulate two basic rules that dominate this culture: For every person holds that the ‘I’ is responsible for the self (1), and for

every group of people holds that all members are responsible for each other, at least to a certain extent (2).

For a very long time the Christian maps and values have dominated the cultural scene. Two developments are of utmost importance here. In the first place, West European culture evolved from a quite primitive culture into a more modern one. In the second place, the Christian heritage split into two parts, a Roman-Catholic and a Protestant variant. The Roman-Catholic variant stresses the role of the Church: imperfect rational and antisocial behaviour can be forgiven by the priest, especially when the sinner pays for it. The Protestant variant, however, stresses the role of the individual believer: God will bless people who develop will-power to stick to the institutions as created by Him. So, Protestant culture stimulates individual self control, thereby creating more rational and social persons. Catholic self control mechanisms are less strong in that respect, and are more dependent on social control.

As already said West European societies became increasingly modern. Modernisation of Christian maps implies a development towards more secularity and individuality. In terms of control we see therefore a decline in the role of religious and social control mechanisms.

Secularisation – we live in the here and now -, and individualisation – an individual person is responsible for his self and for his neighbours -, have affected the institutions of West European societies significantly. The transition from a stable capitalist system towards a stable welfare state in the Dutch society over the period 1860-2008 is a good example. A process of individualisation contributes to this institution, whereas a process of secularisation may also be a threat to it.

### **Cultural Change<sup>11</sup>**

In the Post Napoleonic period the Dutch business sector became increasingly liberated from government regulation. The government became more active in the building up of an efficient infrastructure. The result was some economic growth with small trickle down effects towards the lower ranks. After a long period of political and social peace and slightly improving prosperity an increasing number of people asked themselves and each other whether it was possible to structurally improve their economic and social situation. Is a different society not only desirable but also feasible? They observed that a growing number of people became richer while so many people were still poor, sick, lowly educated and living in caves. It created a rivalry between those who did not believe in progress, and those who saw possibilities to achieve more prosperity and justice. The growing awareness among Christians and atheist workers that societal structures are not god-given or natural, but, to a certain extent at least, man-made implied an important cultural change.

In this atmosphere of increasing rivalry capitalists and different groups of workers were not only competitors on markets, but also rivals in a social game. When conflicts become manifest it becomes possible for the different parties to inform each other about the views and interests which are at stake. They can try to persuade each other of the desirability of particular common strategies. In the first stage of the conflict the fighting groups show their power to each other. If all parties in the conflict are convinced that an enduring fight is not in the long term interest of any of the parties, a

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<sup>11</sup> In Windmuller (1969) an authoritative account is given of the history of Dutch labour relations. In later editions the book got a number of updates. In Roebroeck (2000) a valuable account is given of the origin and development of Dutch welfare institutions. Keizer (2001) gives an interpretation of the reforms of the Dutch welfare state as implemented in the period 1982-2000.

second stage is needed in which all parties are listening to each other with an open mind, and discuss strategies that serve the long term common interest<sup>12</sup>.

In the culture that was emerging parties in power accepted their opponents' interests as important! In other words, there was a growing tendency to seek for consensus rather than to fight for victory. The cultural context was also responsible for the acceptance of leaders of important groups such as political parties, unions and employers' organizations, who had rather rational and social personalities. The Dutch history of labour relations and social policy shows a whole series of examples, in which leaders took wise decisions, leading to institutions responsible for social peace and growing prosperity for most people rather than for a happy few.

### **Different stages of social and institutional evolution**

In the period 1860 – 1914 many unions were erected. The working class became increasingly class conscious. The revisionist variant of socialism dominated the socialist union movement, and the leaders were focused on an evolutionary rather than a revolutionary change in the structure of society. Christian believers increasingly organized themselves separately: politically as well as economically. Unionism actually started in confessional circles. Confessionals warning against socialism and advocating conservative policies were in a minority. Those who advocated institutional change dominated the scene. At moments of manifest conflict leaders of all parties were stressing long term common interest. The confessional government was able to break the Railway Strike (1903), for instance, but nevertheless decided to accept some proposals made by the striking party.

In the period 1914 – 1940 many rules were adopted, of which we can say with hindsight that they were cornerstones of the welfare state as it has developed over a period of about 150 years. Step-by-step a system of collective bargaining was introduced (legislation in the years 1907, 1927, 1937). Moreover, unions and employers' organizations started to build a system of social security, backed by governmental legislation.

In the period 1945 – 1960 there was widespread consensus about the construction of a system of social security and social assistance. The government accepted explicitly responsibility for fair and efficient wages, full employment and a decent living for all who appear unable to take care for their selves. There was hardly any conflict, and the leaders of the different denominations met each other regularly and took important social and economic decisions, all backed by the parliament. Lasting peace and increasing prosperity was the result.

The period 1960 – 1980 is characterised by more and more severe conflicts. As was the case in the first period of many conflicts (the Post Napoleonic period), was this second period of conflict again the result of a relatively long period of peace and growing prosperity. Again, a growing number of people started to wonder whether a different societal structure was feasible: a structure that showed much more economic, social and political equality. This cultural change stimulated socialist and confessional unions and political parties to go for further institutional change. The welfare state had to be extensive, and the redistribution from rich to poor had to be quite strong. These radical reforms were implemented. However, the oil crises in the seventies were the immediate cause of the 'discovery' that a capitalist free market sector cannot

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<sup>12</sup> In a modern-Christian cultural context it is not in the interest of a powerful group to exclude weak groups from economic, social and political participation so as to keep them weak infinitely. Exclusion would not serve their social-rational selves. In a typical economic world with imperfectly social-rational selves destruction of opponents may be a great solution.

bear too much politically organized equality. So, after a period of conflicts the organizations responsible for economic and social policies admitted that the more radical reforms did not serve the long term common interests. In the period 1980 – 2000 the welfare state was restructured without severe resistance. The last decade there is wide spread consensus again about the specification of what is a sustainable welfare state.

### **Mechanisms of change**

If the cultural context does not stimulate individuals to be rational and social, and choose leaders who are rational and social, conflicts will endure. Then the second stage in which consensus must be reached, will not start, and society-wide institutions cannot be developed. Lack of cohesion and trust between the different classes and groups makes it impossible to establish lasting social peace and prosperity for all groups in society.

Economic processes can only be effective in a cultural-institutional setting that stimulates people to be rational and social. Rational people have self control and social people translate the control of their drive to maximize their status in terms of the erection of solidarity systems, such as a welfare state. So if most people are actually very imperfectly rational, solidarity systems will not operate effectively. In practice we all are imperfectly rational, and do not behave completely according to the standards of the cultural ideal-type of Greek-Jewish-Christian civilization. Part of these practices is socially accepted, and keeps people imperfectly rational and social systems quite ineffective. In some countries these deviations from the ideal-typical cultural pattern are larger than in other countries, making their welfare state systems less effective. When leaders of important organizations are quite masculine in their behaviour, for instance, and do not control their drive to maximize social status, it is at the cost of the whole of society. They set an example, and stimulate the rank-and-file to also behave imperfectly rational. For them tax evasion and disobeying rules may be a strategy that leads to short term gain, but to long term cost for society at large. In the Dutch social-economic history of the last one and a half century, time and again quite rational and social leaders set an example to be followed by the mass of the people, thereby serving the long term interests of the whole society.

A last remark must be made about the future prospects. Does it mean that the Dutch welfare system is sustainable? We can only give a conditional answer: as long as Dutch culture does not change significantly the answer is yes. But in practice culture is not a constant. There are two reasons for a slowly evolving culture. On the one hand an endogenous factor: in case of a long period of peace and growing prosperity people have the inclination to lose some control of the self and become less rational and less social over time. In our example it means that leaders take less than rational decisions, and the mass of the people increasingly try to evade taxes and disobey rules, which were accepted by their selves. A welfare state cannot function well if this process holds on. It can only be stopped if this behaviour leads to a crisis and subsequent catharsis. Otherwise institutions are increasingly undermined. In the end it could provoke a cultural change. On the other hand an exogenous factor: a flow of immigrants from countries with a different culture can undermine the cultural foundation of the welfare state. In this case a crisis will not lead to a catharsis, and the autochthonous people must educate the new comers to get them integrated. If a country reacts too late a process of disintegration affects the willingness of the

citizens to stick to the institutions negatively. Then institutional change – in terms of a break down of the welfare state – becomes unavoidable.

## 6. Conclusion

Context gives meaning to phenomena. The external and internal world can only be understood by framing it in a simple but convincing way. Institutions are rules that shape human behaviour, thereby making life simpler and easier to understand. In this way the world becomes more controllable, which diminishes uncertainty and the existential fear that is created by it.

In this paper the context of institutions is the integrated psychic-economic-social world, in which the moral and the political mechanisms are responsible for optimal behaviour. In the economic world institutions are meant to channel the economic force; they are economic-efficiency enhancing devices. In the social world institutions are meant to channel the social force; they are minimising the costs of the status battle and hold society together. In the psychic world institutions are meant to channel the psychic force; they are framing the mind, and help the true-self to develop will-power. Then passions can be controlled in such a way that long term interest of the self is enhanced and personalities integrated.

These institutions must be embedded in a cultural context, which constitutes the basic views and goals of the people. On the basis of these cultural properties people can specify coherent sets of rules of behaviour: institutions. These rules are solutions to economic scarcities, social status battles and lack of self control.

The mechanism of institutional change takes place as follows: an unexpected and undesirable economic development takes place. This creates a social conflict. People involved in the conflict are imperfectly rational and imperfectly social. They are inclined to increase their self-respect by means of masculine behaviour, for instance and to increase their social status by being a tough fighter. The long term common interest is at stake, but that is less relevant for them, compared with the level of self-respect and status. If they are more rational and social the reaction to the conflict will be moderate. They listen to the argumentation of the opponents, and take their interests into account. The consensus that exists among rational and social people, namely that all parties must, at least to a certain extent, participate in society and able to live a decent life, leads to the preparedness to accept compromises. The agreements that are concluded also concern the institutional framework. In the case of the Dutch welfare state we see a slow evolution in the framework that increasingly expresses the ideas of the typical Dutch culture.

A last point to be made is the question of what is the *antonym* of the concept of institution. When we want to know what is a male it makes sense to clarify what we mean by a female. If we want to know what is a junior it makes sense to clarify what is a senior. In case of institution it makes sense to find out what is the opposite of rule following behaviour. It has to do with **discretion**: room for a decision maker to do whatever he desires. He can act emotionally or rationally; but he is at least free to decide, and not bound to a rule that must be applied. Again, the meaning of the term discretion depends on its context. If a boss commands his subordinate to do A in case of B, he requires rule-led behaviour. Suppose that a boss says to the subordinate that he is free to decide what to do in case B, but that the outcome must be C. Now there is

some room for discretion but the room is limited. In this case the limitation is reflected by the necessary output. In general a world that is perfectly free from any institution, offers people a maximum of discretion. Moreover, in this world people can offer their selves maximum room to behave rule-free; not any rule is established to get control over the self. It means that all people behave on the basis of their passions, including the passion to be rational, ignoring any opportunity to learn and institutionalise successful strategies. We can call this world **perfect anarchy**: immediate desires are satisfied as much as possible. Ideal-typical anarchists expect natural processes to be responsible for deep satisfaction rather than maximum frustration, and social harmony will be the result of an anarchic structure. The opposite of perfect anarchy is the perfectly institutionalised world. Given the two extremes, completely ruled versus completely rule-free, there must be an optimal institutional framework; a framework that channels people drives and behaviour most effectively towards the realisation of goals that are considered desirable and feasible in the long run.

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