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Sven Oskarsson, PerOla Öberg and Torsten Svensson
Department of Government, Uppsala University, Sweden

This study tests three hypotheses on data from a survey on employment relations conducted in Sweden in 2006. The first hypothesis implies that the extent to which an employee perceives formal institutions as fair and duly enforced increases the probability that he/she will behave cooperatively. The second hypothesis states that an employee's trust in the opposite party should have equivalent effects. The last hypothesis holds that an employee's perception of formal institutions as fair and duly enforced increases his/her trust in the opposite party. All three hypotheses are supported by the data. The interpretation is that there is indeed an effect on cooperative behavior and willingness to enter into flexible contracts from perceptions of fair and enforced institutions, but it is indirect and mediated by attitudes of trust.

Keywords: cooperation, institutions, political economy, political science

> If the rulebook of capitalism is fixed and fair and enforced, perhaps energetic self-interest will find the path of accelerated development.
> (Roll and Talbott, 2003: 17)

A Brief Outline of the Argument

If there ever was a debate within the social sciences about whether institutions matter at all, it is now obsolete. It is well established within political science (Shepsle, 1989) and economics (North, 1990), but also in related research on individual choice and new institutionalism (Granovetter, 1985; Koelble, 1995), that institutions can influence individuals' behavior. A more fruitful discussion is now prevalent about what kind of institutions matter (Rothstein, 1998, Blyth, 2001), how (Elster, 1989) and under what conditions (Przeworski, 2004).

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Furthermore, the emphasis on institutions and individual behavior has fostered an even closer relationship between research on politics and economy (Hall, 1986; Persson and Tabellini, 2003; Swedberg, 2003). It has been shown that politically constructed and contended institutional arrangements are closely associated with different ‘production regimes’ or alternative models of capitalism (Hall and Soskice, 2001; Thelen, 2004; Streek and Thelen, 2005; Pontusson, 2005). However, the actual mechanisms of pivotal institutions of the political economy remain to be fully understood. Considering the attention given to political institutions over recent decades, scholars may still be ‘struck by how little robust, reliable knowledge we have about the impact of institutions’ (Przeworski, 2004: 528). The aim of this article is to contribute to a better understanding of how politically constructed institutions matter in modern capitalism.

Capitalism is based on the exchange of goods and services in free markets. Such transactions, however, do not come without costs, which vary independently of the competitive market price of the goods or services exchanged. In real life, actors are not fully informed, goods and services are complex, and their quality is hard to determine. The risk of opportunism and the need for extensive contracts increase costs considerably and may even hinder exchange. Consequently, transaction costs and the handling of such transaction costs are crucial for production and, in the end, economic growth. In this article we focus on the labor market and the mechanisms that can reduce these transaction costs.

Thus, creating an environment in which incomplete contracts are entered into and cooperative behavior thrives despite uncertainty about the behavior of others is essential to make market economies work. It has been argued that formal and informal institutions are the keys to the creation of such a low-cost transaction environment. But the existence of institutional constraints is not enough. Their (perceived) quality and performance are equally crucial. We argue that the essential mechanisms are the extent to which third-party enforcement mechanisms (the formal institutions or the rules of the game) are considered both duly enforced and fair, and the extent to which the involved parties trust each other to stick to broadly accepted norms (informal institutions). These two factors may have direct effects on incomplete contracting and cooperative behavior. But, in relation to recent research on institutions and trust, we argue that we should understand this as a chain of mechanisms. More precisely, we argue that the perception of duly enforced and fair rules and regulations leads to higher trust, which in turn influences the willingness to enter into incomplete, effective contracts and to engage in cooperative behavior.

In this article we try to make use of theoretical and empirical knowledge from the study of both politics and economics with the intention of formulating and testing hypotheses on the effects of institutions on the behavior of economic actors. We take the aggregated effects of institutional constraints on economic growth for granted and focus on the labor market and mechanisms at the micro level. We use cross-sectional data from a Swedish survey conducted in 2006 aimed at employees and posing questions about the conditions of and perceptions about their workplaces. Above all we investigate employees' perceptions of and attitudes towards institutions, trust, and cooperative behavior. As expected, and in accordance with earlier research, the analysis shows a positive effect of trust on cooperative behavior and the readiness to enter into flexible contracts. More novel is that perceptions of institutional constraints also have a positive influence on the two outcomes. Furthermore, and more importantly, the analysis confirms our hypothesis about a chain of mechanisms. The results indicate that perceptions of duly enforced and fair institutions positively influence employees' trust in their superiors, which, in turn, leads to more cooperative behavior and an increased willingness to enter into less formalized contracts.

Obviously, these results have important implications for labor market and social politics. In order to create a workplace environment that fosters trust, and by doing so lowers transaction costs, it seems crucial to design institutions that are perceived as fair. We argue that this interplay between political institutions and economic behavior is crucial to the understanding of how – at least one variety of – capitalism works (Hall and Soskice, 2001; Pontusson, 2005; Oskarsson, 2005; Svensson and Öberg, 2005).[1]

Institutions and Transaction Costs – Three Hypotheses

Ever since Douglass North stated that institutions are the 'underlying determinant of long-run performance of economies' (1990: 107), the relationship between institutions and growth has been a central theme, not only in economics but also in the field of social science research in general. A burgeoning literature has set out to determine the extent to which the existence and quality of formal and informal institutions can explain differing growth patterns around the world.

So far, the ample empirical evidence suggests that a wide range of institutional factors is related to measures of economic prosperity and growth. It has been shown that the existence of property rights, civil liberties, political rights, and freedom of the press positively affect growth, whereas black market activity, trade barriers, and excessive regulation hamper economic development (Hall and Jones, 1999; Henisz, 2000; Bockstette et al., 2002; Rodrik et al., 2004; Dreher and Herzfeld, 2005; Persson and Tabellini, 2006). Regarding more informal institutional constraints, cross-country studies support the hypothesis that nations characterized by trusting and civic-minded citizens fare better in economic terms (Knack and Keefer, 1997; Zak and Knack, 2001; Beugelsdijk et al., 2004).

But the institutional explanations of growth have not escaped criticism. Above all, the definitions, measurements, and methods used in the empirical studies supporting a positive effect of well-functioning institutions on growth are highly contested: ‘The growth literature does not subscribe to one overarching definition of economic, political, and social institutions, their process of change, and their likely channels of influence on economic outcome’ (Aron, 2000: 100). A central problem is that the literature has obscured the different channels through which institutions operate and, hence, has impoverished the interpretation of the role of institutions in growth.

Furthermore, the causal order of the factors has been questioned. Do institutions cause growth or is economic growth a prerequisite for the existence of certain institutions? To get a better grasp of the causal direction is of course critical, from both a scientific and a policy perspective. However, in spite of the impressive number of studies showing significant relationships between institutional factors and measures of economic development, most researchers seem reluctant to make the leap from correlation to causation (Aron, 2000; Roll and Talbott, 2003).

A common suggestion in this instance is to collect more and better data to enable more elaborate statistical modeling to solve the problems (Aron, 2000; Roll and Talbott, 2003). Important as this may be, such an approach misses a fundamental point. Although empirical tests of the economic effects of institutions have focused on the macro-level relationship between institutions and growth, mainstream institutional economics has not jettisoned the conventional assumption of methodological individualism (Williamson, 2000; Arvanitidis, 2004). Thus, to better support the causal link between institutions and growth at the macro level it is critical to understand and test in what way institutions affect individual actors (King et al., 1994; Torsvik, 2000). Therefore, we argue that more emphasis must be put precisely on sorting out and empirically testing the assumed individual-level mechanisms underpinning the macro-level relationship between institutions and economic growth. Specifically, what is needed is a clear idea of which institutions matter and for what reason (Elster, 1989; Rothstein, 1998; Przeworski, 2004).

The natural starting point here is to pinpoint exactly what processes institutions are supposed to affect. What is the assumed mechanism between institutions and growth? At the center of institutional analysis is the concept of transactions – joint actions between individuals in which the terms of performance are agreed upon (Martinez and Dacin, 1999). The fundamental problem to solve in order to produce growth is to create an environment in which (economic) actors can get involved in successful exchanges and transactions. But such exchanges of goods, services, and sanctioned rights does not come without costs. These transaction costs follow (among other things) from 'uncertainties that arise from incomplete information with respect to the behavior of other individuals in the process of human interaction' (North, 1990: 25).

More concretely, these costs involve

> the costs of deciding, planning, arranging and negotiating the actions to be taken and the terms of exchange when two or more parties do business; the costs of changing plans, renegotiating terms, and resolving disputes as changing circumstances may require; and the costs of ensuring that parties perform as agreed. Transactions costs also include any losses resulting from inefficient group decisions, plans, arrangements or agreements; inefficient responses to changing circumstances; and imperfect enforcement of agreements. (Milgrom and Roberts, 1990; cited in Husted and Folger, 2004: 720)

In other words, you do not enter into a transaction if you feel uncertain about whether the other actors will stick to it. If you do, you would prefer a very detailed contract in order to try to anticipate every possible kind of unfriendly behavior from the opposite party. The question then is: when will actors successfully make complex exchanges and transactions? Transaction cost analysis is closely connected with the work of Oliver Williamson (1975 and 2000). Briefly, the basic idea is that the cost of transacting is a function of the interplay between two assumptions about human behavior – bounded rationality and opportunism – and two properties of the underlying transaction – asset specificity and uncertainty (John, 1984; Shelanski and Klein, 1995; Crocker and Masten, 1996; Rindfleisch and Heide, 1997; David and Han, 2004).[2] Given that actors have limits to their rationality and constraints on their cognitive capabilities (bounded rationality) and a propensity, when given the chance, to act out of self-interest and, sometimes, even opportunistically, transaction costs will rise as asset specificity increases, the circumstances surrounding the exchange become more uncertain ex ante, and performance is harder to verify ex post. The interplay between these factors will, in the end, determine whether there will be any successful exchange between the actors. It will also determine the efficient form of organization for a given economic relationship – market or hierarchy.

However, the Williamsonian approach has been criticized for putting too much emphasis on the efficiency aspects of transaction costs.

> Where organizational economists are interested in economizing transaction costs, justice theorists are interested in optimizing the perceptions of fairness, whether of the outcome of an exchange or of the process by which the outcome is evaluated. (Husted and Folger, 2004: 721)

When people perceive the allocation of the outcomes of an exchange (distributive justice) or the procedures for determining those allocations (procedural justice) as unfair they will respond by shirking, breaching, and pilfering (Ouchi, 1980; Husted and Folger, 2004). In contrast, when the allocation is seen as fair and just, individuals will cooperate in spite of tragedy-of-the-commons situations (Ostrom, 1990, 2000). That is, perceptions of fairness will facilitate cooperative behavior whereas perceptions of unfairness will lead to increasing transaction costs and less efficient (or lack of) exchanges.

How do these insights help us understand the role of institutions in explaining economic growth? The basic premise of institutional analysis is that institutions will structure human exchange by changing actors' incentives, reducing their uncertainty about the behavior of others, and making credible commitments possible (Hall and Soskice, 2001; North, 1990). Connecting this assumption to the discussion on transaction costs, we should expect the importance of a well-functioning institutional framework to lie first and foremost in its possible effects on the actors' propensity to behave cooperatively. Institutional constraints determine the returns on cooperative behavior (Ostrom, 1990, 2000). Given a proper institutional framework, actors will be more inclined to behave cooperatively. Consequently, proper institutions will lower transaction costs and enable complex and efficient economic exchanges.

But what is a proper institutional framework? In this paper we adhere to North's definition that institutions 'are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction' (North, 1990: 3). This definition is wide enough to encompass both formal and informal institutional constraints. Looking first at the formal constraints, to lower transaction costs there is a need for a formal institutional framework that acts as an impartial third party that is able to enforce agreements, thereby structuring human exchange and making credible commitments possible by changing actors' incentives. The institutional framework can serve this function in two ways.

First of all, following Weber, we argue that to have an effect on actors' expected utilities from different choices a constraint must be effectively enforced:

> To the person who finds himself in possession of power to control an object or a person the legal guaranty gives a specific certainty of the durability of such power. To the person to whom something has been promised the legal guaranty gives a higher degree of certainty that the promise will be kept. These are indeed the most elementary relationships between law and economic life. (Weber, [1922] 1968: 730)

That institutional constraints can influence behavior by affecting the expected utility from different choices of behavior is, of course, well established in the rational choice oriented literature in political science (e.g. Hall, 1986; Shepsle, 1989; Elster, 1989) and economics (North, 1990), but also – although with some slightly different meanings – in related research on economic action and new institutionalism (Granovetter, 1985; Koelble, 1995; Swedberg, 2003). Thus, low-cost enforcement of contracts is an important source of economic growth across the world and throughout history (North, 1990).

Secondly, we argue here that the degree to which the formal constraints governing the relationship are perceived as fair and just by the individuals will enable cooperative behavior in spite of incentives to act opportunistically. The underlying logic is well captured in Rawls' *A Theory of Justice*:

> given that a person's capacity for fellow feeling has been realized [according to the first law], and given that a social arrangement is just and publicly known by all to be just, then this person develops ties of friendly feeling and trust towards others in the association as they with evident intention comply with their duties and obligations, and live up to the ideals of their station. (Rawls, 1971: 490)

Thus, we should expect fair institutions to influence individuals' propensity to act on the basis of moral commitments. In line with the discussion on transactions costs above, the formal constraints governing the relationship should be perceived as fair and just by the actors to enable credible commitments and cooperative behavior (Rawls, 1971; Ostrom, 1990; Ostrom, 2000; Farrell, 2004; Levi et al., 2004). In other words, the mere existence of institutional constraints is not the only way to create an environment that is conducive to economic prosperity. Comparing economic development around the world, it is evident that some institutional constraints lower transaction costs whereas others raise them. What is also important is the quality or performance of institutions rather than their descriptive characteristics or attributes.

The assumption underlying this argument is that most people do not act on the basis of a single rational utility-maximizing utility function. Instead, individuals weigh their self-interest against their commitment to adhere to moral values in a dual utility function (Levi, 1991; Rothstein, 2001). We believe there is reason to expect institutional constraints to affect behavior through both these routes. Thus, we should expect that effective enforcement of institutional constraints primarily influences actors' self-interested preferences, whereas the influence of fair institutions works through the impact on individuals' moral stance. When institutional constraints increase the costs of non-cooperative behavior, individuals will be more inclined to act cooperatively. When the institutional constraints are perceived as fair and just, the actors will attach greater weight to their moral convictions when deciding whether to cooperate or not. The discussion so far has led us to the first hypothesis to be tested in this study:

> H1: the extent to which a transaction party perceives the formal constraints governing the relationship as fair and/or duly enforced will increase the probability that he/she will behave cooperatively.

But even when the formal institutional constraints are perceived as fair and just and enforcement is sufficient to enable complex contracts to be entered into, uncertainty about the possibility of validating whether a contract has been fulfilled will still abound:

> In particular, because contingent agreements are costly to compose and difficult for courts to interpret and enforce, contracts are inevitably incomplete. Although parties will design contracts to balance the need for adaptation with the cost of effecting adjustments, the inability to define precise obligations in response to changing events in ways that can be enforced at low cost means that contracts will, on the one hand, tend to be inflexible and, on the other, leave considerable opportunity to cheat on the agreement or to attempt to evade performance. (Crocker and Masten, 1996: 9)

Thus, because of enforcement costs, most contracts will be incomplete (Miller, 2004). In other words, proper formal institutional constraints are in most circumstances not enough to enable low-cost transacting

(Lorenz, 1999; Darley, 2004: 145). By filling the gaps left by incomplete contracts, *informal* institutional constraints also play a major role in determining transaction costs:

> It should be stressed that creating an institutional environment that induces credible commitment entails the complex institutional framework of formal rules, informal constraints, and enforcement that together make possible low-cost transacting. (North, 1990: 58)

Informal constraints are viewed here as 'broadly accepted standards of conduct' (North, 1990: 61). That is, the essence of informal constraints is norms. In this sense, norms are the informal counterpart of fairly perceived formal constraints. And, as was the case for formal institutional constraints, norms must be abided by to be effective. Two questions follow from this argument. First, how does an actor assess the probability that others will follow norms, however 'broadly accepted'? Second, what is the essence of these broadly accepted norms? This is where trust comes into the picture as an important factor enabling low-cost transacting (Miller, 2004: 101).

Our understanding of trust is based on the model of trust associated with Russell Hardin and his colleagues (Hardin, 2002). An actor A is said to trust another actor B 'when A believes that B is trustworthy with respect to the matters at hand' (Cook et al., 2005: 20). We argue that people can be trustworthy for two reasons: someone is trustworthy if he/she encapsulates our interests and/or is morally committed to being trustworthy. Thus, our account of trust departs from Hardin's conception in one important respect. As noted above, we believe that an individual's actions can be motivated by both self-interest and moral commitment (Levi, 1991). Consequently we argue that an actor's expectation of someone else's trustworthiness can rest on an assessment of both his/her self-interest and moral commitment (Oskarsson et al., 2009).

In this sense trust can be seen as a bet on the extent to which others encapsulate our interests and/or are morally committed to act trustworthily (Sztompka, 1998; Rothstein, 2004). Accordingly, just as norms are the informal counterpart of fair formal constraints, trust is the counterpart of third-party enforcement of formal constraints. To trust someone means to be confident (but not absolutely certain) that he/she encapsulates our interests and/or is morally committed to act trustworthily in future contingencies. That is, high-trust actors 'spend less to protect themselves from being exploited in economic transactions. Written contracts are less likely to be needed, and they do not have to specify every possible contingency' (Knack and Keefer, 1997: 1252). In line with this argument, the second hypothesis holds that:

> H2: the extent to which a transaction party trusts the opposite party will increase the probability that he/she will behave cooperatively.

Thus, institutions affect transaction costs and, ultimately, economic growth through both formal and informal constraints. When actors perceive the institutional framework governing the relationship as fair, just, and properly enforced, and also trust their potential exchange partners, transaction costs decrease, the number and complexity of exchanges rise and the economy flourishes (Podsakoff et al., 2000; Miller, 2001).

But what can be said about the causal order between formal constraints and trust? The earlier literature was a lot sparser on this question. But recent research on the interrelationship between welfare institutions, political confidence, and social trust argues that the institutional framework can create trust. In particular, it has been shown that citizens who perceive welfare institutions as fair and just are more supportive of the political regime and its institutions (Kumlin, 2004) and are more trusting towards their fellow citizens (Rothstein and Stolle, 2003; Rothstein, 2004; Kumlin and Rothstein, 2005). Such feedback mechanisms going from formal institutions to trust might very well be valid in circumstances other than the vertical trust relationship between a citizen and the political authorities and the horizontal trust relationship between citizens.

Following our assumption about dual utility functions and the discussion on trust above, we argue that institutional constraints influence actor A's trust in actor B in two ways. First, properly enforced institutional constraints will make it more expensive for B to break the relationship with A. Thus, A will be more likely to believe that B encapsulates his/her interests and therefore is willing to act trustworthily. Second, given that the institutional constraints are perceived as fair, A will expect B to place greater weight on moral convictions when deciding whether to act trustworthily or not.

Consequently, we should expect the degree of trust in any relationship to be affected by the formal constraints governing the relationship (Oskarsson et al., 2009). Thus, there is reason to state a more general hypothesis about the relationship between institutional constraints and trust and test whether:

> H3: the extent to which a transaction party perceives the formal constraints governing the relationship as fair and/or duly enforced will increase his/her trust in the opposite party.

Methods and Research Design

In order empirically to test the individual-level mechanism underpinning the macro-level relationship between institutions and economic growth, we have, first of all, to pinpoint an appropriate transaction relationship with great importance for economic growth. Furthermore, this relationship should preferably be embedded in easily recognizable institutional constraints, both formal and informal. There are of course several possible situations to study. We argue here that employment relations nicely fit the above-mentioned criteria (Williamson, 1985; Dirks and Skarlicki, 2004; Brehm and Gates, 2004; Cook et al., 2005).

First, laws and other institutions regulate employment relations in all countries, and specify for example industrial management rights, job security, and rules for conflict resolution (Traxler et al., 2001; Botero et al., 2004). Thus, labor market institutions and laws regulate property rights for both employers and employees. Furthermore, since these institutions do not regulate every part of an employment relationship, employers and employees are constantly involved in exchange situations where informal institutions, e.g. norms of acting trustworthily, are also important.

Second, the employment relationship is a typical situation in the sense that the actors are involved in an exchange in which transaction costs follow from uncertainties with respect to others' behavior (Ouchi, 1980; Hall and Soskice, 2001; Darley, 2004). Both employers and employees have incentives to exploit or deceive the other. Consequently, both parties also have incentives to secure themselves from being exploited or deceived, and may be tempted to engage in complicated (and costly) contracts.

Third, successful exchanges and transactions between employers and employees are essential to effective organizational functioning and, hence, economic growth (Dirks and Skarlicki, 2004; Brehm and Gates, 2004). Not only is it important that agreements are settled; they have to be settled without too large costs arising from complicated contracts and supervising.

The Data

In order to study the effects of institutional constraints on employee behavior and attitudes we rely on an extensive survey of Swedish workplace relations. The Swedish case is a highly suitable testing ground for the three hypotheses outlined above. Most importantly, labor laws in Sweden are extensive and universal. Most employees in Sweden have comparable job security and are affected by one distinct system of conflict resolution when involved in individual disputes (Kjellberg, 1998; Wood, 2001; Thelen, 2001: 86–8; Traxler, et al., 2001: 77, 208, 302).

The survey was conducted in cooperation with *Statistics Sweden* in late spring 2006. A random sample of 3000 respondents was selected based on a register of all Swedish citizens between 20 and 65 years of age; 1551 individuals answered the postal questionnaire after three reminders, i.e. a response rate of 52 percent. The analyses in this article are based on answers from the slightly more than 900 respondents who indicated that they had been working mainly as employees in the last month. Before we proceed to the analysis, we will explain how our basic concepts are measured.

Cooperative Behavior and Flexible Contracts

To tap the respondents' willingness to cooperate we turn to the concept of organizational citizenship behavior (Podsakoff et al., 2000; Nyhan, 2000; Dirks and Skarlicki, 2004). Organizational citizenship behavior has been defined as:

> Individual behaviour that is discretionary, not directly or explicitly recognized by the formal reward system, and that in the aggregate promotes the effective functioning of the organization. By discretionary, we mean that the behaviour is not an enforceable requirement of the role or the job description, that is, the clearly specifiable terms of the person's employment contract with the organization; the behaviour is rather a matter of personal choice, such that its omission is not generally understood as punishable. (Organ, 1988; cited by Podsakoff et al., 2000: 513)

Organizational citizenship behavior (OCB) has been specified and measured in several different ways. Podsakoff et al. (2000) in their review of the literature pinpoint no fewer than seven different meanings of the concept. As the most central among those they emphasize what may be called *helping behavior*, which 'has been identified as an important form of citizen behavior by virtually everyone who has worked in this area' (Podsakoff et al., 2000: 516). In order to capture this, we asked our respondents to what extent they were willing to 'work harder than they normally do' in order to help their nearest superior.

A potential objection to using OCB as an outcome variable in the models below is that, in the causal chain, one's willingness to engage in helping behavior is in close proximity to one's trust, at both the conceptual and the operational level. Therefore we will also employ an alternative measure of transaction costs as a dependent variable. In the literature, individuals' willingness to enter into flexible contracts has been highlighted as an important aspect of low-cost transactions (Miller, 2004). Thus, high-trust actors will 'spend less to protect themselves from being exploited in economic transactions. Written contracts are less likely to be needed, and they do not have to specify every possible contingency' (Knack and Keefer, 1997: 1252). Given a situation of uncertainty, low-trusting employees will prefer a very specific contract in order to avoid being exploited. To capture willingness to enter into flexible contracts we asked the respondents which they regarded as most important: 'to have considerable scope for workers as well as managers to make continuous changes in work tasks' or 'to have strictly defined work assignments'.

Perceptions of Institutions

The institutions that regulate employment relations in Sweden encompass two bodies of law: employment law and collective relations law. In international comparisons, the level of employment protection is high in Sweden (Pontusson, 2005: 119–25). Job security is regulated in special legislation dating back to 1974 and primarily stipulated in the Employment Protection Act (SFS, 1982: 80; Holmlund and Storrie, 2002). The law presumes that, unless otherwise stipulated, an employment contract is valid until further notice. When terminating a contract, the employer must provide a valid reason – the circumstance appealed to should constitute a 'just cause' for dismissal – and advance notice. Furthermore, the Act states that the order of priority in a redundancy situation shall be determined on the basis of employee seniority. This is often referred to as the 'last in, first out' principle. However, there are exceptions to this redundancy selection criteria system: small companies are permitted to exempt two of their workers from this provision.

Collective relations laws protect workers from employers through collective action (Botero, 2004: 1355). These laws are more disparate than employment laws. A characteristic trait of Swedish collective relations laws is that they involve the organizations of the labor market to a very great extent. When a dispute between an employer and an employee arises, the first stage for the employee is to approach his/her workplace trade union representative. The issue is then negotiated with the employer at workplace level under the terms of the Co-Determination Act (SFS, 1976: 580; e.g. Levinson, 2000; Pontusson, 2005: 117). If the local parties are unable to resolve the conflict, negotiations will follow between the employer's association and the trade union at national branch level. If they too are unable to reach a resolution of the conflict, the case can be taken to the tripartite Labor Court, where it can be settled through continued negotiations or arbitration, or – as a last resort – by a formal decision by the Labor Court.

In the analysis we will focus on respondents' perceptions of the rules for dismissal and conflict resolution. As stated above, we argue that the extent to which the institutional constraints are perceived as fair and/or duly enforced is decisive. Ideally we should have separate measures tapping, respectively, the perceived fairness and the perceived enforcement of dismissal and conflict resolution rules. Unfortunately, this is not the case. Instead we measure the extent to which respondents perceive the rules for dismissal to be enforced and whether they think the conflict resolution rules are fair.[3] In the end this means that, although we are able to test the effects of perceived fairness and perceived enforcement separately, we cannot tell which effect is stronger.

An obvious objection against using perceptions of institutions is the fact that the analysis is based on a survey from one institutional context. The aim of the study is to uncover the individual-level mechanisms underpinning the cross-country relationship between institutions and growth. Thus, the best strategy would be to use data from a large set of countries in order to ascertain whether or not there actually is some cross-country variation in how individuals perceive institutional efficiency and fairness. Unfortunately this is not possible and instead we focus on a single institutional context. In line with this, a first and very reasonable assumption we need to make for our argument to be valid is that there is some cross-country variation in the aggregate level of individual perceptions of institutions reflecting the cross-country variation in actual institutional settings.

However, one more quite plausible assumption is needed. As is evident from the descriptive statistics, the degree of variation in how individuals perceive labor market institutions in Sweden is substantial. The mean score and standard deviation on the 0–10 scale measuring perceived enforcement of dismissal rules are 7.57 and 2.77, respectively. The corresponding results for the perceived fairness of the conflict resolution rules are 5.54 and 2.60. Thus, although the formal rules are the same, individual perceptions of the rules vary a great deal. There are two possible sources of this variation. First, the perceptions might be fundamentally subjective. Second, the perceptions might reflect informal practices across different workplaces. In the brief discussion above we pointed to the possibility of reaching workplace-specific solutions within the national framework of both employment protection law and collective relations law in Sweden. Consequently, and as will be evident in the results section, we favor the second possibility and hold that a large part of the variation in individual perceptions of institutions is caused by such informal practices across workplaces.

Trust

As argued in the theory section, we consider trust to be a bet on the future contingent actions of others, based on incomplete information concerning others' interests and moral commitment. Trust is measured in two different ways in this article. First, respondents were asked a straightforward question about the extent to which they trust their nearest superior. The second question takes as its starting point the concrete situation after an agreement or contract has been reached, namely the extent to which the employee thinks that superiors actually keep their word and do what they have promised to do. Together these questions cover the two situations of ex ante transaction costs (search and contracting) and ex post transaction costs (monitoring and enforcement costs) (Dyer and Chu, 2003). In our analysis we have combined the two questions into a single additive index of trust.

Analysis

The results of the analyses are presented in Tables 1 and 2.[4] The estimates of the seven regression models in Table 1 are intended to test the influence of institutional constraints on organizational citizenship behavior. In order to save some space, we present only the estimates of the relevant variables measuring perceptions of formal institutional constraints and trust. All variables in the table are measured using 11-point scales (0–10).

Focusing on Model 1, we can see that the first hypothesis is supported by the results. The degree to which the respondent thinks that rules for dismissal are followed at the workplace is positively related to the expressed willingness to work harder than one normally does in order to help one's superior. In the same manner, the estimates in Model

3 strongly confirm the second hypothesis. The more the employee trusts his/her nearest superior, the more willing he/she will be to put in extra effort in order to help his/her boss. This particular result is not novel. The relationship between trust and organizational citizenship behavior is well documented in earlier research and the estimates in Model 3 confirm these findings (Dirks and Ferrin, 2001; Podsakoff et al., 2000; Dirks and Skarlicki, 2004).

In contrast, the results in Models 4 and 6 provide us with some important and much less well-documented insights. When including both the measure of trust and the respondent's perception of employment laws as predictors in Model 4, the direct effect of the latter on organizational citizenship behavior is non-existent, whereas the influence of trust remains more or less unaffected. From these results we can conclude that there is a strong correlation between the two measures of formal and informal constraints. This suspicion is confirmed by the results in Model 6, where the trust indicator is regressed on the employee's opinion about the rules for dismissal. The estimates reveal a strong positive relationship between the two variables.

The interesting question then is how to interpret this pattern of estimated coefficients. Is the fact that the effect of the respondent's perception of employment laws on organizational citizenship behavior vanishes when controlling for trust in the nearest superior an indication that the relationship found in Model 1 is spurious? Or should we instead interpret the relationship as causal but indirect?

Since we are dealing with cross-sectional data we cannot solve this problem empirically. Instead we have to rely on reasoned arguments. Although we cannot rule out the possibility that trust is an important precondition for the establishment and maintenance of formal institutional constraints, we believe there are stronger arguments for the opposite causal ordering: that the degree of trust in any relationship will be affected by the formal constraints governing the relationship (see Dirks and Skarlicki, 2004: 27).

This is especially true of the particular case at hand. To measure respondents' perceptions of formal institutional constraints regulating employment relations we asked the respondents to what extent they thought that rules for dismissal were followed at their workplaces. Given the transparency and centrality of this rule for Swedish employment relations it is reasonable to assume that an employee has first-hand knowledge of whether or not the law is conformed to at his/her workplace. Thus, already being informed, an employee's trust in his/her superior should not affect the degree to which he/she thinks the rules for dismissal are obeyed. The opposite scenario, however, is more plausible. The degree to which the rules for dismissal are deviated from at a particular workplace will lead to lower levels of trust among the employees.

Therefore we can conclude that the results in Models 1, 3, 4, and 6 provide support for all three hypotheses. Both the degree to which the respondent thinks that rules for dismissal are followed at the workplace and his/her trust in the nearest superior are positively related to the expressed willingness to work harder than one normally does in order to help one's superior. Furthermore, and interestingly, it seems that the effect of the formal institutional constraints is primarily indirect and channeled via the trust indicator. Thus, when the rules for dismissal are complied with at the workplace, the employees' trust in their superior increases, which, in turn, positively influences the willingness to engage in organizational citizenship behavior.

Do these results hold when turning to the relationship between the respondents' perceptions of the fairness of the conflict resolution rules and their willingness to engage in organizational citizenship behavior? Looking at the pattern of effects presented in Models 2, 3, 5, and 7 in Table 1, one is struck by the similarity between these results and the ones presented above. The respondent's perception of conflict resolution rules (Model 2), as well as trust in his/her superior (Model 3), positively affects the willingness to work harder than one normally does in order to help one's superior. We can also see that the estimated effect of the employee's perception of conflict resolution rules decreases when controlling for trust (Model 5) and that there is a strong positive relationship between the two explanatory factors (Model 7).

Once again these results leave the door open for interpretation. This time the argument for understanding the relationship between perceptions of the fairness of conflict resolution rules and organizational citizenship behavior as causal but indirect rather than spurious is not as obvious. Above all, it does not seem too far-fetched to think that an employee's trust in his/her superior could affect perceptions of how rules for conflict resolution function at the workplace. However, the results in Table 1 confirm findings from a conceptually similar but empirically different field of research stating that citizens who perceive welfare institutions as fair and just are more supportive of the political regime and its institutions (Kumlin, 2004) and more trusting towards their fellow citizens (Rothstein, 2004; Kumlin and Rothstein, 2005). In line with this we argue that there is good reason to believe that the results of Models 5 and 7 indicate that a large part of the effect of the respondents' perceptions of

TABLE 1
OLS Regression Models for Organizational Citizenship Behavior (OCB) and Trust

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
	(Vertical OCB)	(Vertical OCB)	(Vertical OCB)	(Vertical OCB)	(Vertical OCB)	(Trust in Superior)	(Trust in Superior)
Rules for dismissal (enforcement)	.288*** (.034)			.006 (.030)		.412*** (.031)	
Rules for conflict resolution (fairness)		.393*** (.037)			.088*** (.032)		.477*** (.033)
Trust in superior			.686*** (.031)	.683*** (.034)	.640*** (.036)		
Adjusted R^2	.108	.168	.442	.441	.447	.226	.261
n	903	903	903	903	903	903	903

Note: Robust standard errors in parentheses. All models are controlled for: sector of employment, occupational status, employment status, size of company/organization, company seniority, employee responsibility, educational level, gender, and age.

Significance levels: * < .10; ** < .05; *** < .01, two-tailed tests.

fair rules on their willingness to engage in cooperative behavior is channeled through trusting attitudes towards the superior.

Proceeding now to Table 2, the models test the effects of institutional constraints and trust on respondents' willingness to enter into more flexible contracts. The outcome variable measures, on a threefold scale, whether the respondent prefers 'to have strictly defined work assignments' (0), is indifferent (1), or prefers 'to have considerable scope for workers as well as managers to make continuous changes in work tasks' (2). In order to take the ordinal character of the variable into account, the estimates in Table 2 are obtained using ordered logistic regression.[5]

Two overall patterns emerge when comparing the results presented in Table 2 with the findings from Table 1. First of all, the effects are generally weaker and less accurately estimated. Also, the predictive capacity of the five models is not overwhelmingly impressive. But this should come as no surprise. A possible objection to the strong effects found in Table 1 is that the respondent's willingness to engage in helping behavior is located rather close to the two hypothesized explanatory factors in the causal chain, especially in relation to the trust variable. The same cannot be said about the dependent variable used in Models 8 through 12. Employee trust and perceptions about rule compliance and fairness are less obviously connected to the stated readiness to enter into flexible contracts. Thus, we should expect somewhat weaker results when changing the dependent variable from willingness to engage in helping behavior to willingness to enter into flexible contracts.

Second, and more important, it is evident that, in spite of the less obvious connection between the dependent variable and the predictors, the pattern of estimated effects in Table 2, with one exception, reveals a close resemblance to the one presented in Table 1. Hence, concerning perceptions of rule compliance all three hypotheses are supported by the results in Table 2. We can see that respondents' perceptions of the rules for dismissal (Model 8) and vertical trust (Model 10) are positively related to the readiness to enter into less formalized contracts. When including both trust and rules for dismissal in the model (Model 11), the size of the former effect is only marginally affected, whereas the impact of the latter sharply decreases. The interpretation carries over from the results presented in Table 1: the positive relationship between rule compliance and willingness to enter into flexible contracts is causal but indirect and channeled through employees' vertical trust in their superiors (Models 3 and 11).

TABLE 2
Ordinal Logit Regression Models for Willingness to Enter into Flexible Contracts

	Model 8	Model 9	Model 10	Model 11	Model 12
Rules for dismissal (enforcement)	.049** (.025)			.022 (.029)	
Rules for conflict resolution (fairness)		.082*** (.028)			.060* (.032)
Trust in superior			.077*** (.028)	.065** (.033)	.045 (.032)
Pseudo R^2	.026	.029	.028	.028	.030
n	903	903	903	903	903

Note: Robust standard errors in parentheses. All models are controlled for: sector of employment, occupational status, employment status, size of company/organization, company seniority, employee responsibility, educational level, gender, and age.

Significance levels: * < .10; ** < .05; *** < .01, two-tailed tests.

Turning instead to respondents' perceptions of the fairness of the rules for conflict resolution, the results are more ambiguous. On the one hand we can see that the first hypothesis is supported. Perceptions of fair rules for conflict resolution positively influence one's willingness to enter into more flexible contracts (Model 9). On the other hand, Model 12 indicates that the positive and significant impact of perceptions of fair rules on the willingness to enter into flexible contracts is somewhat smaller but still substantially and statistically significant when controlling for trust in the superior. Furthermore, the effect of trust is no longer significant. Thus, in this particular case, the results run counter to the claim of the third hypothesis that trust is the critical link between perceptions of institutions and cooperative behavior.

Conclusions

Although an emphasis on institutions and trust has been fundamental in both political science and economics, especially over recent decades, there have been few cross-disciplinary studies. However, in line with recent studies in the political economy field (Persson and Tabellini, 2003), we have tried to make use of theoretical and empirical knowledge from the study of both politics and economics with the intention of formulating and testing hypotheses on the effects of institutions on the behavior of economic actors.

Well-known economists Oliver Williamson and Douglass North and their followers have argued that institutional constraints and trust among people may reduce transaction costs in market economies. In the field of political science, researchers have shown empirically that perceiving relevant political institutions as fair may produce political (vertical) as well as interpersonal (horizontal) trust. By making use of these overlapping but separate theoretical frameworks, we formulated three hypotheses that we tested on data from a survey conducted in Sweden in 2006. First, we investigated whether the extent to which an employee perceives formal institutions as fair and duly enforced increases the probability that he/she will behave cooperatively. Second, we tested whether an employee's trust in the opposite party had equivalent effects. Third, we examined whether an employee's perception of formal institutions as fair and duly enforced increased his/her trust in the opposite party.

The first two hypotheses were strongly supported by the data. Concerning the third hypothesis, three out of four tests confirmed our claims. Thus, the results indicated that trust is the critical link between perceptions of duly enforced rules for dismissals and organizational citizenship behavior (Model 4) and willingness to enter into flexible contracts (Model 11), respectively, and between perceptions of fair rules for conflict resolution and organizational citizenship behavior (Model 5). However, the estimated effect of perceptions of fair institutions on the readiness to enter into flexible contracts (Model 12) did not fit into this pattern. Here we could not find any support for the claim that trust works as the critical link between the two factors. All in all, then, the results do provide some but not full support for the third hypothesis. The somewhat more ambiguous results concerning the role of trust in the causal link between perceptions of fair institutions and cooperative behavior call for further investigations.

As always, the study is flawed, having some measurement problems, and interpretations are not totally unambiguous. The perception of fair and enforced institutions should ideally be measured using two separate questions. As it is now we have information only about the extent to which employees think that rules for dismissals are followed at the workplace and that rules for conflict resolution are fair. Thus, although we are able to test the effects of perceived fairness and perceived enforcement separately, we cannot tell which effect is stronger. Furthermore, to empirically solve the problem of causal order between attitudinal constructs such as trust and perceptions about institutional fairness we need panel data. Lastly, in this article, we use data from Sweden only, and cross-country comparisons would provide a useful test of robustness.

In spite of these problems, the interconnection between politics and the economy is obvious. In a high-trust workplace, conditions for lower transaction costs are better. Not only are employees prepared to engage in exchange situations without specifying work tasks in a complicated contract and, hence, take the risk of exposing themselves to discretionary decisions by the managers; employees are also willing voluntarily to work harder than stipulated in the incomplete contract if they regard it as important to the company. The important lesson here is that the degree of trust is not a given; relevant institutions can create it. At the workplace, institutions regulating dismissal and conflict resolution are of course essential, a finding that seems to be neglected in other studies of trust in organizations where the attributes of the supervisor are emphasized instead (e.g. Dirks and Skarlicki, 2004; Brehm and Gates, 2004: 60). Whereas others have been discussing the effects of predictable (rigid) versus flexible rules, we argue that another important aspect is to have political processes that create institutions that are perceived as fair and duly enforced by the parties affected by them (Öberg and Svensson, 2009; Oskarsson et al., 2009).

Lessons from research on varieties of capitalism have taught us that economic growth may be accomplished within several different institutional environments (Pontusson, 2005). Hence, it may well be that trust between employers and employees is more important in a coordinated market economy, which 'generally entails more extensive relational or incomplete contracting' (Hall and Soskice, 2001). In any case, the conclusion is that fair and enforced political institutions are *at least one* way to make capitalism work.

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Notes

1. Thus, it should be stressed here that our argument about making market economies work primarily relates to the so-called coordinated market economies. As has been pointed out in the literature on varieties of capitalism (Hall and Soskice, 2001), there are other routes to growth than trust and cooperative behavior in the uncoordinated market economies. On the other hand, the distinction between coordinated and uncoordinated market economies refers to pure ideal-types, and actual market economies around the world should be characterized as more or less coordinated/uncoordinated. Consequently, a workplace environment that fosters trust and lower cooperative behavior should, to a greater or lesser degree, also promote growth in countries characterized as more uncoordinated.
2. Asset specificity includes relation-specific investments in physical and human capital, such as firm-specific training of employees. In addition to asset specificity and uncertainty, the literature on transaction costs has suggested, but given less attention to, two more dimensions of transactions – frequency and complexity (Rindfleisch and Heide, 1997).
3. The two items read: 'To what extent do you think that disagreements between employers and employees at your workplace are solved in a fair way?'; 'To what extent do you think that layoff rules are strictly observed at your workplace?' In both cases the response alternatives run from 0 ('To no extent at all') to 10 ('Completely').
4. All significance tests in the models are based on robust heteroskedasticity-corrected standard errors (Huber-White).
5. We have also estimated the five models using a multinomial logit specification. The estimated effects from these models are very similar to those presented here. For reasons of simplicity we have therefore chosen to retain the more intuitive ordered logit results.

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Sven Oskarsson

is assistant professor in political science at Uppsala University, Sweden. His current research interests concern power, trust, and loyalty in the Swedish labor market and political support among the affluent democracies. His recent publications include articles in *Politics & Society* and *Rationality & Society*, and book chapters and books.

Torsten Svensson

is professor in political science at Uppsala University, Sweden. His current interests concern power, trust, and loyalty in the

Swedish labor market and within the labor market elite. His recent publications include articles in *West European Politics*, *Governance*, *Scandinavian Political Studies*, and *Rationality & Society*, and book chapters and books.

PerOla Öberg

is associate professor in political science at Uppsala University, Sweden. His current interests concern social networks of trust and deliberation, and knowledge-based politics. His recent publications include articles in *West European Politics*, *Governance*, *Scandinavian Political Studies*, and *Rationality & Society*, and book chapters and books.