

# **Institutional Economics**

**Bernard Chavance**

Routledge Frontiers of Political Economy

# Institutional Economics

This introduction to *institutional economics*, follows the history of the field since the early 20th century to the present day. It concentrates on influential authors in the main schools of institutional economics.

*Institutional economics* is defined as economic thought that considers institutions to be relevant to economic theory, and consequently criticizes the neo-classical mainstream for having pushed them out of the discipline; it deals especially with the nature, origin and evolution of institutions, and their effects on economic performance. It is a family of different theories that were initially influential in economics, then lost much of their weight in the middle half of the twentieth century, and eventually recovered significant creative vitality and impact in the last 20 years. The book puts the recent developments in historical perspective by showing how important themes, like the importance of habits, the role of formal and informal rules, the relationship of organizations and institutions, the hierarchy and complementarity of institutions and the evolutionary character of institutional change, have been explored by various authors or schools.

Despite the proliferation of scholarly writing about institutional economics there has been a long-standing gap for a volume which introduces the topic. This book fills that gap and will be useful reading for all advanced students of economics as well as scholars involved at the cutting edge of economics research.

**Bernard Chavance** is Professor of Economics at the University Paris Diderot, France. He has published several books on comparative economic systems and institutions, particularly on socialist systems and post-socialist transformation. His book *Economic Reforms in the East: From the 1950s to the 1990s* (1992, Nathan) has been translated into English (US), Russian, Japanese and Chinese.

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# 1 Introduction

## The institutionalist families in economics

Institutional economics can be regarded as a family of theories that share the thesis that ‘institutions matter’ in the study of economics, that they even constitute an essential subject of reflection. This family is therefore distinct from theories in which economics as a discipline does not have to take account of institutions, on the grounds that these fall under other disciplines such as political science, sociology or history.

Although the classical English school, whose influence predominated throughout almost all the nineteenth century, took an interest in economic institutions such as ownership, which determined the class structure, or the desirable scope and nature of government legislation, it was the currents of thought contesting the classical tradition that were the first to devise an institutional approach to economics. These were the German historical school and American institutionalism, the international influence of which was considerable at the end of the nineteenth century and during the first three decades of the twentieth century, especially in the United States, where institutionalism aroused significant interest, both in the academic world and in connection with the New Deal. However, from its origins the Austrian school had also developed an institutional dimension in its long-running dispute with the historical school.

Starting in the 1940s, however, the ‘neo-classical’ movement was to acquire undisputed international hegemony, based in the United States, and would virtually crowd out the institutionalist inheritance. According to this approach, which finally came to dominate the whole of the twentieth century, the central theme of economics as a discipline is the market: analysis was based on equilibrium involving the action of rational, calculating and utilitarian individuals and was concerned mainly with efficiency. Institutional questions and the historic dimension of economic processes were reduced to a minimum, sometimes totally eliminated. Although institutional themes continued to be heard in numerous sub-disciplines, such as labour economics or the study of industrial relations, the analysis of large

## 2 *Institutional economics*

corporations or development economics, it is no exaggeration to say that the dominant school of economics in the second half of the twentieth century deliberately almost entirely ignored institutions.

In the final 20 years of the century, however, a gradual change took place in the complex relationships between different economic theories (Hodgson, 1994). A vigorous school known as ‘new institutional economics’, of neo-classical descent and again originating in America, emerged. This school distanced itself from the earlier dominant school by stressing the importance of institutions such as property rights or alternative ‘modes of governance’ like the market and the hierarchy of firms. About the same time, there was a revival of the first institutionalist school (the ‘old institutional economics’), again operating from an American base but developing mainly in Europe. Moreover, several innovative currents of thought, such as evolutionary economics, showed a manifest affinity with this tradition. Lastly, the resurgence of the Austrian school that accompanied the major neo-liberal revival at the end of the twentieth century led to the reactivation of another long-forgotten branch of institutional economics. Obviously, the historical context had much to do with this evolution, with the scale of the institutional changes taking place in the capitalist world starting in the 1980s, the crisis and subsequent transformation of the socialist systems and the considerable differentiation of the developing economies constituting upheavals calling for institutional analysis of a kind that the paradigm of equilibrium and the conventional *ceteris paribus* hypothesis were hardly capable of handling. Furthermore, following an undeniable running out of steam of its research programme and under the impact of the renewed institutional approaches, even the neo-classical family has been doing more to extend its method and concepts to institutional questions, as shown by the theories of ‘public choice’, property rights, ‘law and economics’, constitutional economics, contract economics, agency economics, etc.

At the beginning of the twenty-first century, the theoretical and methodological conflicts between the various currents of economic thought concerning the role of institutions have therefore taken on a quite different form. A new and fairly broad consensus now predominates, namely that ‘institutions matter’. An economist who declared himself to be institutionalist 20 or 30 years ago had to be prepared to face sarcasm; today, institutionalism is rather fashionable. Certainly, differences of approach, method and conceptualization remain important, often irreducible, but we are also seeing a redrawing of frontiers between currents of thought, between orthodoxy and various types of heterodoxy and, in general, the vitality of the various currents working in the same field of ‘economics with institutions’ is a relatively encouraging sign, given the current malaise of economic thought that characterizes the times we live in (Chavance, 2001).

This book has been designed as an introduction to the various significant strands of institutional economics, and as an invitation to a more thorough reading of the authors and currents that make up this composite family within economic theory. It is clearly not exhaustive and suggestions for additional reading are to be found in the Bibliography. The method adopted consists of focusing successively on certain significant authors or currents of thought.

Chapter 2 deals with original institutionalism, the historical school through Schmoller, American institutional economics through Veblen, Hamilton and Commons, along with Polanyi. Chapter 3 considers the Austrian school through Menger and Hayek, as well as Eucken's 'ordoliberalism'. The American 'new institutional economics' is presented in Chapter 4 through the work of Williamson and North, as well as of two authors basing themselves on game theory (Aoki and Greif). Chapter 5 covers certain contemporary European currents of thought: the theory of regulation, the school of conventions and Hodgson's evolutionary institutionalism. Finally, Chapter 6 discusses the questions of unity and diversity within the family or the field of institutional economics.

## 2 Original institutionalism

### Schmoller and the German historical school

Gustav von Schmoller (1838–1917), the leading figure in the ‘younger German historical school’, is an essential but sometimes overlooked source of institutionalist currents of thought. He was a promoter of the approach based on the ‘national economy’ (*Volkswirtschaft*), and a defender of the social reforms carried out by an enlightened monarch, in his case the Prussian king, and an opponent of both Manchester school liberalism and socialism. In the history of thought he is mainly remembered for his dispute with Menger at the time of the *Methodenstreit* (quarrel over methods), and his thinking has often been caricatured or forgotten.

#### *Institutions and organs*

In his *Grundriss der allgemeinen Volkswirtschaftslehre (Principles of Political Economy, 1900–1904)*, Schmoller posits that the comparative study of the political economies of different nations at different periods must concentrate on ‘institutions and organs’ (the latter term being close to the notion of organization), alongside natural and technical conditions. ‘The study of the organ and the institution is, for the knowledge of the social body, what anatomy is for the physical body.’ The ‘old’ political economy that concentrates on prices and the circulation resembles ‘a physiology of economic humours that is not preceded by an anatomy of the social body’ (Schmoller, 1900: 156).

By *institutions*, of a political, legal or economic nature, we mean an arrangement at a particular point in the life of the community, serving set objectives, that has attained its own existence and development and which forms a framework or mould for the action of successive generations over hundreds or thousands of years.

(Schmoller, 1900: 156)

Examples of institutions include property, slavery, serfdom, marriage, the market, money and industrial freedom (1990: 149). An institution therefore represents 'a set of habits and rules of morals, custom and law, which have a common centre or goal, which are consistent with each other and which constitute a system' (1900: 150). The concept of organ (or organic formation) is directly linked to that of the institution.

By constituted organ (*Organbildung*) we mean the personal aspect of the institution: marriage is the institution, the family is the organ (*Organ*). Social organs are the constant forms taken by the union of persons and goods with a view to the attainment of given objectives: the *gens*, the family, associations, corporations, confraternities, communes, firms, the State, these are the essential organs of social life.

(1900: 150)

The first organs in history are those of communities such as the tribe, the *Sippe*, the family. Originally, these embrace all the objectives that, following differentiation and separation, give birth to other social organs, such as spatial organizations (village-level, town-level, national), having objectives serving the public interest and private enterprises aimed at making profits. The development of culture is accompanied by an extension of various organs 'and most frequently there emerge alongside the spontaneous organs, organs stemming from an intervention of human will'<sup>1</sup> (1900: 150).

The more complex society becomes,

the greater the possibility for a man to be member of a number of extremely diverse social organs, to which he belongs sometimes for ever and sometimes only for a certain time, which sometimes relate to his entire interest and sometimes only to a small fraction of his interest.

(1900: 151)

Within organs relationships of domination and dependence or relationships of confraternity are built up. But in the large organs there are authorities that are superior to the individual, these authorities persist regardless of the replacement and turnover of their members and this gives the organs substantial durability. Schmoller notes, from a methodological viewpoint, 'when one looks at the whole [of society], at order, at general orientation, one has to take into consideration the social organs no less than the individuals' (1900: 132).

## 6 *Institutional economics*

### ***Institutions, freedom and progress***

The different sciences dealing with the State and with the law, as well as those dealing with society and the economy, had tended to either over or underestimate the role of institutions and organic formations. Mercantilism and cameralism, as well as individual thinkers like Hobbes or Frederick the Great, gave precedence to institutions, the State and the law. Revolution reversed this approach and the liberal doctrine opposed the individual and his freedom to the State and to state institutions. But this individualist liberalism confused the rejection of outdated institutions with the desire not to have any durable institutions. While it is true that the contract has often supplanted the institution, it also remains true that alongside the former one sees ‘the mass birth of new organic formations and social institutions’ (1900: 155), a tendency that Schmoller says should be welcomed. As for socialism, it initially attached exaggerated value to voluntary institutions and organic formations, before rejecting, in utopian fashion, the existing State and its institutions in conformity with the doctrine of socialist democracy.

For Schmoller, the desirable social state is the one in which institutions are not an obstacle but a stimulus,

where the fixed institutions and the free interplay of individual forces complement each other . . . through a just reciprocity, where institutions do not without reason prevent freedom’s advance but, on the contrary, operate in the desired direction of development.

(1900: 155)

In the end, he puts forward a fairly positive vision of institutions: ‘they are the materialization of objective methods, they are the maxims embodying all that the wisdom of centuries has deemed to be best regarding the rational and just handling of practical relations’ (1900: 155).

While it is true that the historic progress of the economy is characterized by greater abundance of economic goods, it remains true that ‘this only takes place with better institutions and increasingly complicated organic formations’ (1900: 156). The great periods of progress are those of the reform of institutions and the creation of new organs, as exemplified recently by corporations, workers’ associations, joint-stock companies, cartels, legislation regulating factory work and the organization of insurance.

### ***Custom and law***

For Schmoller, there is an essential relationship between morals, custom and law. Custom stems from habit and practice, which are then transformed into

usage through the intermediary of moral sentiments. Each usage is explained by the history of *mores*:

this is a complicated result, in which many diverse ideas and causes have come into play in combination. Moral judgement and sentiments, material needs and objectives, old formulas, religious fantasies, false ideas, the exact knowledge of the causes and of what is useful to the individual and society all make their contribution.

(1900: 123)

We shall find a similar thesis regarding the ambivalence of institutions when we come to discuss American institutionalism.

The rules imposed by custom and *mores* are essential to economic life. Anyone who regards only the technical, material and quantitative aspects in attempting to understand it 'fails to capture exactly what gives economic life its colour, its specific aspect' (1900: 123). Historically, the law (*jus*) is differentiated from custom (*mores*) in that it confers the power of sanction on certain rules that it spells out and rationalizes. But the sphere of custom always overreaches and exceeds that of formal law, despite having no identifiable executing entity, unlike the latter. In most fields of human activity, there is coexistence between custom and law: marriage, family life, business relationships, economic organization, sociability and political life 'have their customary practices and their law' (1900: 123). The injunctions of custom are based on public opinion, those of law on the power of the State and those of morality on personal conscience.

Generally speaking, morality is more flexible than custom or law; 'the capacity to adapt always disappears over time as the result of the rigidity of law and of custom' (1900: 129).

Several major themes that were later to be developed by American institutionalism are therefore present in the 'younger German historical school' represented by Schmoller in the early years of the twentieth century. Apart from the attempt to integrate the historical approach and the theoretical approach, this is especially true of the relationship between institution and organization, the distinction between the spontaneous and deliberate formation of institutions, the relationship between custom and formal law and the idea that institutions crystallize both knowledge and ignorance.

### **Veblen's 'evolutionary institutionalism'**

Thorstein Veblen (1857–1929) is one of the key figures in the 'economic study of the evolution of institutions'. He was an extraordinary character,



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who has left us works of a surprising originality and force, which require a serious effort to read.

### **Veblen's principal writings**

*The Theory of the Leisure Class: An Economic Study in the Evolution of Institutions*, 1899.

*The Theory of Business Enterprise*, 1904.

*The Instinct of Workmanship, and the State of the Industrial Arts*, 1914.

*Imperial Germany and the Industrial Revolution*, 1915.

*The Higher Learning in America: A Memorandum on the Conduct of Universities by Business Men*, 1918.

*The Place of Science in Modern Civilization and Other Essays*, 1919.

*The Vested Interests and the Common Man*, 1919.

*The Engineers and the Price System*, 1921.

*Absentee Ownership and Business Enterprise in Recent Times: The Case of America*, 1923.

### ***The errors of the 'non-Darwinian' theories***

Veblen's essential criticism of the established economic theories is that they are 'pre-Darwinian'. For Veblen, Darwinism was not only a theory of biological evolution, but above all a general model of an 'evolutionary science' that had influenced a number of disciplines by the end of the nineteenth century – but not economics.

Veblen is the inventor of the term 'neo-classical', by which he means 'modernized classical concepts', in particular those of Marshall. This expression, which for him has critical content, was later to be taken over by the 'neo-classical' authors themselves. This term underlines the continuity between the classical school and the theories that were developed at the end of the nineteenth century (and later, during the twentieth century), although Veblen by no means overlooked the changes and revisions occurring in the dominant current of 'economic science'<sup>2</sup> (Veblen, 1899–1900). He reproached the English classical economists for their teleological bias, their postulate of progress and their utilitarianism, but also for a confusion between the normative approach and factual analyses. The classical tradition was above all 'taxonomic', meaning that it had remained at the stage of the classification of categories, it was not in the least 'genetic' or evolutionary and had invented an inaugural stage of the economy in order to justify its normative position. As for the neo-classical authors, although they made superficial references to evolutionism, their conception of the laws of

equilibrium economics was confined to a static approach and prevented them from thinking in terms of an opaque and non-teleological ‘cumulative causal sequence’, which was, according to Veblen, the basis of the post-Darwinian science of evolution. They limited their investigation to the constraints posed by the economic conditions, without wondering about cumulative transformation and the diversification of human activities that result from institutional change (1898: 77). The institutional factors were ‘taken for granted, denied or explained away’ (1909: 233) – note that the three postures of expulsion of institutions from ‘economic science’ are here clearly identified.

Veblen’s criticism of the utilitarianism of the marginalist school (which he calls hedonism) is justly famous. In this approach, man is seen as

a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but lead him intact. He has neither antecedent nor consequent. He is an isolated, definitive human data, in stable equilibrium except for the buffetings of the impinging forces that displace him in one direction or another.

(1898: 73)

He is not a living process, but is driven by external forces.

The fundamental error of both the Austrian school and the English economists was to postulate a ‘passive and substantially inert and immutably given human nature’ (1898: 73). Even supposing that a utilitarian and rational ‘economic man’ had become the dominant figure of the contemporary world, it still had to be explained by what evolutionary process, of selective adaptation, he had come into existence.

In the end, Veblen’s criticisms of the theories existing in his time formulated and anticipated a large number of the heterodox criticisms of the dominant current of economic thought in the twentieth century, especially concerning the following points: the implicit role played by normative postulates; the antagonism between an equilibrium-centred conception having as its model the physical and mechanical sciences and a vision primarily focused on change inspired by a general science of evolution; the exogenous and immutable character of the assumed preferences of the individual, reduced to a rational calculator and having no motivation other than personal utility; and, finally, the neglect of the essential role of institutions in real-life economic processes.

***The limitations of Marx and of the historical school***

Despite having been strongly influenced by Marxian thought, Veblen is notable for having formulated a rarely heard criticism of Marx, namely that he retained as part of his theory of the class struggle a rationalist and utilitarian standpoint, with the different classes acting in reasoned fashion in the light of their own interests (1896–7: 441). In a Darwinian approach, however, there is nothing to guarantee that the interest of the working class will lead it to oppose the capitalist class; and the workers' 'training in subservience to their employers' (in other words, the effect of habits of thought) on the contrary may prompt them to accept the equity and excellence of the established system of submission and unequal distribution. Moreover, Veblen expresses his opposition to the view that an individual is solely a social being, merely acting as intermediary for social laws. Finally, he stresses the neo-Hegelian teleologism underlying the Marxian conception of history in general and of capitalism in particular, which he describes as romantic and pre-Darwinian.

Veblen also criticizes the German historical school for their descriptive approach, consisting of merely enumerating the data and providing a narrative account of industrial development, without supplying a genuine economic theory (1898: 58). The irony is that this criticism was later to become the leitmotif of an alleged refutation of the institutionalist school itself. For Veblen, however, it applied mainly to the 'older historical school' while Schmoller's work came closer, in a positive manner, to a Darwinian evolutionary institutionalist theory of a 'genetic' – and no longer Hegelian – nature. Schmoller's limitations were said to lie in his failure to distinguish adequately between his theoretical reflections and his concern with social reform (1901a).<sup>3</sup> Even so, Schmoller and the younger historical school had a major influence on Veblen's thought and on American institutionalism more generally.

***The case for an evolutionary science of economics***

Veblen sets out in explicit fashion one of the important characteristics of what was to become the American institutionalist school, namely the link between the central role given to institutions and the evolutionary approach that focuses on the process of economic change above all else. While he borrows from American pragmatist philosophy (James, Dewey) the concept of 'habit of thought' that he uses to define the institution, it is from Darwinism interpreted as a general theory and methodology that he takes his non-teleological category of 'evolution', under the influence of Spencer in particular.

Veblen (1898) accordingly draws particular attention to the fact that at the end of the nineteenth century, economics had not yet become an evolutionary science, in other words a theory that focuses on a process or an unfolding sequence having neither origin nor a final term, based on ‘cumulative causation’.<sup>4</sup> On the contrary, the traditional notions of (natural) law, equilibrium and perturbing causes lead in the end to a ‘system of economic taxonomy’ concerning the normal relations of things (1898: 67).

An evolutionary economic theory must have economic action as its subject. Individual life admittedly represents ‘an unfolding activity of a teleological kind’, in other words one that aims at certain objectives, but these objectives are not immutable. An individual’s economic activity is ‘a cumulative process of adaptation of means to ends that cumulatively change as the process goes on, both the agent and his environment being at any point the outcome of the last process’ (1898: 75). The notion of the possible existence of a ‘legitimate trend’ towards a predetermined end, in other words the normative teleological approach of classical and neo-classical economic science, is contrary to evolutionary thought, inasmuch as the latter is ‘a theory of a cumulative sequence of economic institutions stated in terms of the process itself’ (1898: 77). One might say that in this approach institutional change is deemed endogenous to long-term economic movement.

According to Veblen, the ‘genetic method’ of modern science deals with ‘the forces and sequence of development and seeks to understand the outcome by finding how and why it has come about. The aim is to reorganize social phenomena into a theoretical structure in causal terms’ (‘Review of *Pure Sociology*’ (1903), quoted by Hodgson (2004), p. 152).

### *Nature and origin of institutions*

Society in general and the economy in particular are evolutionary groupings of institutions; the evolutionary economic science that Veblen tries to construct is therefore centred on institutions, which are the *prevalent habits of thought and action* in the social community.<sup>5</sup> Their essential feature is a certain relative inertia with regard to social evolution; they were formed in the past and are inherited from the past. ‘Institutions are products of the past process, are adapted to past circumstances and are therefore never in full accord with the requirements of the present’ (1899: 126). However, the institutions themselves emanate from habits of life:

but habits of thought are the outcome of habits of life. Whether it is intentionally directed to the education of the individual or not, the

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discipline of daily life acts to alter or reinforce the received institutions under which men live.

(1901b: 121)

### *Instincts and habits*

The formation of institutions, or of habits of thought, results from a complex interaction between various levels and temporalities of evolution. The deepest level is that of 'instincts' or hereditary propensities, the result of selection over a long biological and social period in the history of man.<sup>6</sup> According to Veblen, these instincts are divided into, on the one hand, interdependent favourable propensities operating for the benefit of society (serviceability), and, on the other, detrimental or problematical propensities, also interlinked, that run counter to the interests of the group. The first set includes the instinct of workmanship, the parental bent and idle curiosity; the second comprises the predatory instinct, the propensity for emulation and the self-regarding instinct. The two sets of instincts mutually influence or 'contaminate' each other, however, in response to historic configurations.

At this first level, a crucial opposition exists between the instinct of workmanship and the predatory instinct. The second level of the evolution is that of habits, these ways of thinking and acting that are formed in particular historic and material circumstances, notably of a technological nature; habits both express and modify the instinctive dispositions and constitute the foundation of the institutions that can be regarded as the third level of evolution. Thus,

the habitual elements of human life change unremittingly and cumulatively, resulting in a continued proliferous growth of institutions. Changes in the institutional structure are continually taking place in response to the alternative discipline of life under changing cultural conditions, but human nature remains specifically the same.

(1914: 12)

### *Veblenian dichotomy and dualisms*

Veblen's interpretations often use the word 'dichotomy' to describe the contrasting interaction he finds to be operating between technology and institutions. The former, which stems from the propensity for workmanship and idle curiosity, is always changing and dynamic, while the latter are relatively inert and resistant to change. This concept recalls Marx's dialectic of productive forces and relations of production, but with several significant differences: according to Marx, history goes through successive moments of

correspondence and conflict between the forces and relations of production, with opposing consequences for the dynamics of the system; the productive forces are more comprehensive than technology (including also natural conditions, workers' skills, the organization of production, etc.). While the production relations concept shows a certain similarity to that of the institution, it is nevertheless explicitly limited to the productive sphere. Certain American institutionalists, notably Ayres, were later to intensify Veblen's dichotomy, while at the same time making it universal and accentuating an opposition between the technological and 'ceremonial' aspects of activity.

Dualist oppositions are numerous in Veblen's theory, however, with their ultimate foundation to be found in the conflict of instincts. As we have seen, these belong to one of two antagonistic groups, this being especially true of the instinct of workmanship and its opponent predatory instinct. These two basic propensities are constantly but diversely expressed in different institutional and historical contexts, which the author summarizes in a series of phases of evolution.<sup>7</sup> In the 'primitive savage' phase, the instinct of workmanship is favoured by crude technology as the needs of survival place the accent selectively on the productive effort. When technological evolution permits the appearance of a surplus, this opens the stage of 'barbarism', in which predation tends to predominate. The next stage, that of the 'quasi-peaceable' handicraft industry, featuring free competition between craftsmen, sees a decline in predatory tendencies and a revival of the instinct of workmanship. Finally, in the 'machine era', corresponding to modern capitalism, predation again takes the upper hand vis-à-vis the instinct of workmanship. However, the non-teleological character of institutional evolution and the consequent absence of natural or normal laws make it impossible, in Veblen's opinion, to predict the later tendencies in this conflict of instincts (1899, 1914).

The interplay of these different dualisms culminates in the opposition between industry and business that is typical of capitalism. Veblen describes the latter as a system founded on large-scale mechanical industry and driven by *business* principles founded on investment for profit. An opposition between the industrial and pecuniary (business) factors then develops: the former correspond to the management of practical processes directed towards material service (*serviceability*), the latter have as their final objective exchange values. The pecuniary dimension, where one again finds the predatory instinct, hampers industrial activity, in which it is the instinct of workmanship that prevails above all.

The capitalist institutions 'that make up the economic structure' may be distinguished in two categories, 'according as they serve one or the other of two divergent purposes of economic life (. . .), the categories of acquisition

or of production'; these are the 'pecuniary or industrial institutions' or the institutions 'serving either the invidious or the non-invidious economic interest. The former category has to do with 'business', the latter with industry' (1899: 136–7).

However, the pragmatic habits and discipline generated by machinism, especially among workers and engineers, develop the concepts of causality and are in opposition to the traditional views regarding natural law, stimulating socializing tendencies and calling into question private ownership as an archaic institution (1904, 1921).

### ***Institutional evolution***

Veblen consequently affirms the existence of an interaction between technology, which is essentially dynamic, and slow-moving instincts and habits, which underlie the evolution and selection of institutions. He differs from the uni-linear progressive evolutionism of the nineteenth century, stressing institutional inertia and the preservation of archaic features, but also the possibility of acquiring the technology of more advanced societies and therefore skipping over certain stages of evolution (see his book on *Imperial Germany* and his writings on Japan). He mainly differs in his refusal of any form of teleology.

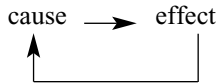
The needs of economic life are continually changing, notably under the impact of the 'discipline' required by changes in technology, leading to the constitution of habits of thinking and doing, of social conventions that interact and mutually reinforce each other, extend to various aspects of social life, are incorporated into law and acquire a definite duration and inertia. These institutions represent an 'outgrowth of habit' and 'the growth of culture is a cumulative sequence of habituation, and the ways and means of it are the habitual response of human nature to exigencies that vary incontinently, cumulatively' (1909: 241).<sup>8</sup>

The existence of an institutional lag means that 'history records more frequent and more spectacular instances of the triumph of imbecile institutions over life and culture than of peoples who have by force of instinctive insight saved themselves alive out of a desperately precarious institutional situation' (1914: 16). The vision that Veblen proposes is mainly sceptical and critical of institutions, while at the same time he underlines their essential role in the economy and society.

### ***Cumulative causality***

The notion of cumulative causality is central to Veblen's evolutionist institutionalism. First of all, it implies a sequential approach to change,

marked by the irreversibility of time and the cumulative character of successive transformations. The concepts of ‘institutional trajectory’ or ‘path-dependency’ developed by evolutionist economists at the end of the twentieth century can be regarded as an extension or a rediscovery of Veblenian concepts. The same can be said of the supplementary notions of self-reinforcement or increasing returns to adoption inasmuch as Veblen’s approach corresponds explicitly to a kind of ‘recursive causality’. Unlike the linear and determinist concept of causality (cause → effect), recursive causality can be defined by the reverse influence of the effect on the cause:



This form of causality is found in the thesis that institutions are an object but also a factor of selection in the evolutionary process (see below). When applied to relationships between the individual and the institution, it leads Veblen to distance himself from both methodological individualism and holism. Institutions result from individual actions but then in turn condition them, so that any methodological reduction, whether based on the individual alone or on the institution alone, has to be excluded.

The growth and mutations of the institutional fabric are the outcome of the conduct of the individual members of the group, since it is out of the experience of the individuals, through the habituation of individuals, that institutions arise; and it is on this same experience that these institutions act to direct and define the aims and end of conduct.

(1909: 243)

Scientific inquiry in this field ‘must deal with individual conduct and must formulate its theoretical results in terms of individual conduct’ (1909: 243). Psychological mechanisms must be taken into account in the analysis of individual behaviour, but these mechanisms include the operation of institutions:

the situation of today shapes the institutions of tomorrow through a selective, coercive process, by acting upon men’s habitual view of things, and so altering or fortifying a point of view or a mental attitude handed down from the past.

(1899: 126)



As stressed by Hodgson (2004), for Veblen the ‘preferences’ of individuals are endogenized by means of the evolutionary role of institutions, rather than constituting unexplained and, in the end, mysterious data concerning individual action.

### *The evolutionary selection of institutions*

Evolution was not the only concept Veblen borrowed from Darwin; he also took the notion of natural selection, which he was to transfer from biology to institutions.

The evolution of social structure has been a process of natural selection of institutions. . . . Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitude; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection.

(1899: 125)

This singular process of ‘natural selection’, in other words an unconscious and non-teleological sifting, has nothing in common with a ‘selection of the fittest’ (a notion introduced by Spencer), which means a selection of the best adapted institutions, since institutional inertia implies a permanent time lag in selective adaptation with regard to the more rapidly changing context of the necessities of life. Veblen’s vision, which was often critical and sceptical vis-à-vis institutions in general and ‘imbecile institutions’ in particular, such as the ‘leisure class’, is in contrast to the theses of social Darwinism, which, at the end of the nineteenth century, offered an interpretation of (social) selection as a blind process of perfecting or optimization that had nothing to do with Darwin’s own conception.

The dual nature of institutions, on the one hand subjects of a process of selection but on the other also factors of selection at another level, explains their influence on the process of change, i.e., adaptation, of individuals themselves: ‘the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions’ (1899: 125). There is therefore a complex combination of co-evolution and reciprocal determination of the changes in the social milieu and of the formation and selection of institutions – what one might call an institutional ‘dialectic’ had this expression not been rejected by Veblen as Hegelian. This dialectic

operates in interaction with the most deep-seated level of human instincts, themselves conflictive but more stable on a historic scale.

### **Hamilton: ‘institutional economics’**

Walton Hamilton (1881–1958), an economist heavily influenced by Veblen, was an important champion of institutional economics between the two World Wars in the United States. His teaching made a contribution to its broad dissemination and many of his pupils were to play a role in the New Deal or, after the Second World War, in the United Nations and the International Labour Organization (ILO).

#### *An advocate of institutional economics*

It was in a programme statement at the annual congress of the American Economic Association in 1918 that Hamilton first made use of the expression ‘institutional economics’, referring notably to Cannan, Veblen, Mitchell and Hobson (Hamilton, 1919) and opposing it to the ‘value economics’ that had been the dominant current of thought since Adam Smith. Institutional economics turns out to be a more promising theory than ‘neo-classical economics’ on several decisive points. It is capable of unifying economic science inasmuch as, in describing economic organization in general terms, ‘it makes clear the kind of industrial world within which such particular things as money, insurance, and corporate finance have their being’ (1919: 132); it reveals their nature and highlights their role in a much wider context. It provides a response to the ‘modern problem of control’ by demonstrating that institutions constitute social arrangements capable of change rather than natural phenomena, but also by emphasizing that apparently conscious activity is controlled by conventions and habits of thought.<sup>9</sup> Its central thesis is that institutions are the real subject of economic theory and it places the emphasis on *processes* and not on equilibrium. An institution such as competition, property or the price structure forms part of a development process that occurs ‘both by a change in its relation to other things and by subtle changes going on within’ (1919: 132). Lastly, institutional economics is based on an acceptable theory of human behaviour by referring to modern social psychology which highlights, in particular, the role played by impulses and instincts instead of the rationalist individualism and the utilitarianism that are the caricatural features of neo-classical economics. It is in the diversity of institutional situations that it seeks the principal source of differences in individual behaviour.

For Hamilton, institutional economics is itself undergoing a development process. It does not oppose the major contributions of the various schools –

classical, neo-classical, Austrian, socialist – but seeks to incorporate them in a theory of economic order suited to the problems of the time (Hamilton, 1919).

### ***Social usage and habits***

In a summarizing article in the *Encyclopaedia of the Social Sciences* (1932), Hamilton provides a remarkable formulation of the concept of the institution, inspired by Veblen. The institution is ‘a cluster of social usages’, designating ‘a way of thought or action of some prevalence and permanence, which is embedded in the habits of a group or the customs of a people’ (p. 84). It is synonymous with procedure, convention, arrangement, and mores. ‘Institutions fix the confines of and impose form upon the activities of human beings’ (p. 314). Culture represents the aggregation of diverse institutions, each of which fixes a type of behaviour and outlines a ‘tolerance zone’ for an activity or complementary activities. The examples of institutions he provides reveal a very broad acceptance of the concept. He instances domains of informal usage such as common law, higher education, literary criticism, athleticism and the moral code (inasmuch as they involve sanctions or impose taboos), along with formal institutions such as the government, Church, university, firm, trade union (all of which issue directives, impose penalties and exert authority over their members). He also considers the money economy, classical education, chain stores, religious fundamentalism and democracy to be institutions, as well as market, burial, worship, dietary, work life and sexual union.

Whereas Veblen tended towards an essentially critical interpretation of institutions, Hamilton, while taking up the theme of institutional inertia and stressing the fact that institutions outlive the problems that brought them into existence and can play roles that are substantially different from their original roles, develops the idea of an essential ambivalence of institutions, since they in fact embody ‘the knowledge and ignorance, the hopes and fears of a people’ (1932; 84). Institutions tend to adapt to changes in culture and context: ‘the life of an institution depends upon its capacity of adaptation. But always amid the whirl of change elements of disorder are present; and long before a harmony is achieved between unlike conventions disintegration has set in’ (1932; 86). Similarly, the transposition of an institution into a different society necessarily implies its transformation: ‘the nucleus is liberated from its cultural matrix and takes on the character of the usages among which it is set down’ (1932; 86).

### ***Institutional conversion***

Often born of situations that are contingent, local and of their own time, institutions can nevertheless then acquire lasting significance and much broader scope. For example, the repeal of the Corn Laws became distinguished from the particular circumstances that caused it to become a general theory of free trade. Old rules are reconverted to serve new uses, as shown by the successive interpretations of the Christian Bible in the course of history. This ‘conversion’ of institutions can even take the form of complete reversals. Thus,

a community of ascetics develops into a wealthy monastic establishment; a theory of social contract as a justification of monarchy is converted into a sanction for its overthrow; a party dedicated to personal freedom becomes the champion of vested wealth; and a philosophy contrived to liberate thought remains to enslave it.

(Hamilton, 1932: 86)

In fact, institutions have an innate tendency to drift, being marked by a propensity to diverge from the initial intentions of their original promoters.

Paradoxically, ‘institutional drift’ is also linked to inertia. An informal institution generates established habits, ideas and interests that give it support. If it becomes formal, its organization and its staff may take on an ecclesiastic, legalistic and ritualistic character that is then transformed into fetishism. Although an institution initially represents ‘an answer to a social problem’, the interests and the compromises involved finally rigidify it, to the point that it will be replaced only through revolution or extinction. Hamilton also insists on the fact that an institution tends to prompt arguments for its legitimization that are more in the nature of rationalization than of reason. ‘The tangled thing called capitalism was never created by design or cut to a blue print; but now that it is here, contemporary schoolmen have intellectualized it into a purposive and self-regulating instrument of general welfare’ (1932: 87).

The institution, as a living thing, has a composite nature: it contains the vestiges of both design and accident, as well as the traces of the ideas and customs of various periods, societies and civilizations. Understanding its significance necessitates having recourse to the genetic method (the institutional approach), but even this cannot fully explain the way in which it came into existence.

***The ambivalence of institutions***

Hamilton's (1932) conclusion highlights the complex or contradictory nature of the institution,

an imperfect agent of order and of purpose in a developing culture. . . . Intent and chance alike share in its creation; it imposes its pattern of conduct upon the activities of men and its compulsion upon the course of unanticipated events. Its identity through the impact of idea upon circumstance and the rebound of circumstance upon idea is forever being remade. It performs in the social economy a none too clearly defined office – a performance compromised by the maintenance of its own existence, by the interests of its personnel, by the diversion to alien purpose which the adventitious march of time brings. It may like any creation of man be taken into bondage by the power it was designed to control.

(p. 89)

The institution simultaneously represents an instrument, a challenge and a danger: 'in its wake come order and disorder, fulfilment, aimlessness and frustration'. In the final analysis, 'institutions and human actions, complements and antitheses, are for ever remaking each other in the endless drama of the social process' (p. 89).

The institutionalist outlook put forward by Walton Hamilton thus stresses both the centrality and ambiguity of institutions, which constitute factors of order and disorder, which embody knowledge and ignorance while being forever subject to historic drift, conversion and forgetfulness of origins.

**Commons: organizations and institutions**

John Roger Commons (1862–1945) is the second most important figure in American institutionalist thought after Veblen (Bazzoli, 1999). While there are themes and concepts that are common to both authors, especially the decisive importance of institutions in economics, their approaches nevertheless differ substantially on a significant number of questions.

Veblen was a critical analyst of institutions, affirming that practical considerations must not interfere with science; Commons sees institutions in a more positive light and is directly concerned with the problems of social reform, to which he devotes a large part of his activity. Veblen declared himself to be opposed in principle to the intrusion of normative criteria into theory, while Commons is searching for 'a reasonable capitalism'. The one condemned the collective action of employers' organizations and trade

### Commons' principal writings

*The Distribution of Wealth*, 1893.

*Proportional Representation*, 1896.

*Trade Unionism and Labor Problems*, 1905.

*Races and Immigrants in America*, 1907.

J. R. Commons *et al.* (eds), *A Documentary History of American Industrial Society*, 10 vols, 1910–1911.

J. R. Commons *et al.* (eds), *History of Labour in the United States*, 1918–35, 4 vols.

*Industrial Goodwill*, 1919.

*Industrial Government*, 1921.

*The Legal Foundations of Capitalism*, 1924.

*Institutional Economics. Its Place in Political Economy*, 1934.

*The Economics of Collective Action*, 1950.

unions that expressed only ‘vested interests’, while the other, on the contrary, sought to promote it and institutionalize it. Veblen defended an evolutionary form of economic science based on the concepts inspired by Darwinism, such as cumulative causality and non-teleological evolution. Commons advocates a theory combining law, economics and ethics, without insisting on the need for a general vision of the evolution of institutions. His approach consists of developing institutional economics by combining the ‘insights’ of the economic schools of the past with a theoretical construct based on the institutional innovations that had occurred in American capitalism at the end of the nineteenth and the beginning of the twentieth century, basing his theory on the legal interpretation provided by judges and the courts of common law, as well as by the United States Supreme Court.

### *The limitations of economic theories*

The history of economic thought occupies an important place in *Institutional Economics* (1934), Commons’ major work. However his approach is somewhat singular, even disconcerting at times. Where Veblen took the opposite stance to the classical and neo-classical tradition, Commons seeks rather to stress the limitations and the partial or outdated character of the various previous currents of thought, while trying to incorporate them – after reinterpretation – in institutional economics. In addition to the underestimation of institutional questions, previous economic theories, in his view, had two major defects. They postulated natural abundance and a consequent harmony of interests instead of seeing the universality of scarcity and hence of the resulting conflicts. For example, Adam Smith believed that

an invisible hand spontaneously made interests compatible, whereas in reality it was the ‘visible hand of common-law courts’ that consciously selected the right customs and imposed them on reluctant individuals. Smith had, therefore, not understood that compatibility of interests was ‘an historic product of collective action’ emanating from the conflict of interests (1934, p. 162). Moreover, economic theories had tended to concentrate on psychology rather than on the role of institutions. This psychology was centred on relations between men and things and ignored the relations between men that concern ownership. It was of an individual character, whereas in fact it was the ‘social psychology of negotiations and transactions, arising out of conflicts’ (1934: 440) that mattered. The result was a confusion between material goods and the categories of income linked to ownership.

According to Commons, equilibrium theories took as their model Newton’s laws of motion and they proceeded by personification, attributing a purpose to social mechanisms that tended towards harmony of interests. Process theories (Veblen) looked at change and at evolution resulting in unintended transformations, taking their inspiration from Darwinian natural selection. The institutional theories or ‘going concern theories’ – defended by Commons – were based simultaneously on equilibrium theories and process theories, focusing on intentional or deliberate change. Their concern was not with automatic equilibrium but with ‘managed’ equilibrium, placing the emphasis on the ‘artificial selection’ of ‘working rules’<sup>10</sup> through reasoning based on ‘social control’ (1934: 120–1).

### ***The ‘institutionalized mind’***

The individual occupies an important place in Commons’ approach, but has to be seen as an ‘institutionalized mind’.

Individuals begin as babies. They learn the custom of language, of co-operation with other individuals, of working towards common ends, of negotiations to eliminate conflicts of interest, of subordination to the working rules of the many concerns of which they are members.

(1934: 73)

They come together, not as ‘globules of desire’ driven by pleasure and pain ‘but as prepared more or less by habit, induced by the pressure of custom, to engage in those highly artificial transactions created by the collective human will (1934: 74).

Commons stresses that individuals belong to several different organizations. Note that one of the few influential American economists in the second

half of the twentieth century to acknowledge an explicit debt to Commons, Herbert Simon, was to stress, in contrast to the new institutional economics, the formula of an 'organizational economy' as being more relevant than that of a 'market economy' in characterizing contemporary capitalism (Simon, 1991: 42). 'Instead of isolated individuals in a state of nature, they are always participants in transactions, members of a concern in which they come and go, citizens of an institution that lived before them and will live after them' (Commons, 1934: xvi).

### ***Going concerns***

The active organization, or 'going concern', with its working rules is in Commons' view what characterizes advanced capitalism. These organizations are innumerable and come in all shapes, but they fall into three main categories: economic, political and cultural. Individuals are simultaneously members of different organizations, which is another name for institutions. The economy, like society, represents a complex of organizations, ranging from the very smallest, such as the family, to the largest and most comprehensive, namely the State. Apart from certain manifest differences, going concerns have characteristics in common: duration (they survive the entry and departure of individuals), sovereignty or autonomous power, legitimate authority, working rules, sanctions and transactions. However, the general model of the organization is in fact based on the interpretation given by Commons to the largest of them, the one that overarches all the others, namely the State. It can be seen in this connection that, like the majority of theoreticians of capitalism, he sees it as existing in a national framework. The theory he constructs is nevertheless explicitly based on American capitalism and he hardly touches on the subject of differing national forms of capitalism.

Any going concern possesses, like the State, legitimate 'authoritative figures', having 'sovereignty', whose role includes notably that of laying down and sanctioning the working rules of the organization. These rules are mainly established following the common law method, at times of conflict, through an artificial selection of unorganized rules which then become organized rules (or collective action). It is therefore the common law model that Commons generalizes, describing, as we have seen, the members of an organization as being its 'citizens'. The State (more precisely the American democratic State of the beginning of the twentieth century) becomes in a way the generic model of any going concern.



**The 'working rules'**

Custom plays an important role for the author of *Institutional Economics*. For him it represents unorganized collective action (that could also be called informal rule) and is even more universal than organized collective action. He regards it as erroneous to believe, like Sir Henry Maine, that custom has been historically supplanted by contract; in reality, customs remain central although they change along with economic conditions. However, they lack precision and this gives rise to conflict, so that the authorities running the organizations are led to give them more precision by selecting those that from now on will be formalized, codified and accompanied by economic or legal sanctions. This process is at work in any concern, up to the formalization of law through decisions of common law judges. But any organization also includes the equivalent of statutory law, which, in the case of the State, results from political processes.

The analogy with law and its different components is, in Commons' view, the basis of the theory of the rules of various organizations or going concerns, which in a way represent 'societies' (Gislain, 1999) of different sizes. Every concern

must have its working rules, which are its laws. These spring from authority, custom, habit, initiative, or what not. They are the common law, the statute law, and the equity jurisprudence of the concern. The state, the business concern and the cultural concern are alike in their dependence on these working rules, the difference being mainly in the kinds of sanctions, whether physical, economic, or moral, which they can bring to bear in enforcing the rules.

(Commons, 1924: 332–3)

Finally, the working rule does not establish *a priori* harmony of interests, because conflict is irreducible, but it creates a 'workable mutuality' and orderly expectation for individuals in their transactions (Commons, 1934: 92). This thesis brings together what might be called a political approach and a co-ordinating vision of rules.

**A theory of transactions**

In Commons' view, wealth has a twofold significance: it is a material thing but it is also the ownership of that thing. The modern conception of ownership, which includes corporeal, incorporeal and intangible property, becomes the basis of institutional economics, which is also 'proprietary economics'. Whereas previous theories were focused on commodities, work,

desires, individuals or exchange, these new theories take as their central subject or analytical unit the 'transaction', a concept that includes simultaneously conflict, dependence and order. The transaction is the 'unit of transfer of legal control' (1934: 5), intervening between the product of labour studied by the classical economists and the pleasures of consumption, of the hedonist economists. It is not limited to the exchange of commodities but consists of the transfer of the rights of future ownership of physical things between individuals (1934: 58). The 'legal-economic nexus' is therefore declared to be central.<sup>11</sup>

The going concern is defined as the joint expectation of beneficial transactions, regulated by 'working rules'. Transactions take three forms: bargaining transactions, managerial transactions and rationing transactions. According to Commons this typology has general and exhaustive validity, being aimed at introducing a distinction between what economists had previously bundled together erroneously in the single concept of exchange.

Table 2.1 Three types of transactions

<i>Transactions</i>	<i>Bargaining</i>	<i>Managerial</i>	<i>Rationing</i>
Position of individuals	Legally equal	Legally superior and inferior	Legally superior and inferior
Negotiational psychology	Persuasion or coercion (in relation to the <i>bargaining power</i> of parties)	Command and obedience	Pleading and argument
General principle	Scarcity	Efficiency	Equity
Identity of principal	Absence of distinction between principal and agent	Individual or hierarchy	Collective authority
Object of transaction	Ownership transfer (debts of performance and payment)	Wealth creation	Distribution of wealth (apportioning benefits and burdens)
Execution of future commitment	Prices and quantities	Input and output	Budgets; taxes; price-fixing; wage-fixing

Sources: Commons (1934, pp. 59–68, p. 106); Commons (1950: 57)

Bargaining transactions take place between parties that are equal from a legal viewpoint, but may be unequal from an economic point of view, in terms of 'bargaining power'. Managerial transactions and rationing transactions imply a legal relationship between a superior and an inferior, between manager and managed. In the first case, the manager is an individual or a hierarchy that issues orders; in the second, the superior is of a collective nature (board of directors, arbitration tribunal, authoritarian government, taxing authority, etc.) and he distributes between the subordinates in the concern its burdens and its benefits. The three modes of transaction have economic, legal and ethical dimensions.

Commons also distinguishes between 'strategic' transactions and 'routine' transactions. The first relate to the 'limiting factor' of the action, the second to its 'complementary factors'. The limiting factor of the action is the one whose control, carried out in the appropriate form and at the appropriate time and place, activates the complementary factors in order to obtain the desired results (1934: 629). However, the limiting and complementary factors are continually changing places. Once placed under control, the limiting factor becomes complementary and another factor becomes the limiting factor. Commons insists on the universality of this model and on its link with the problem of temporality: the limiting factor is the subject of present action; in the case of the complementary factors, the individual expects that these will be stable in the future. He therefore has no need to concentrate his attention on them as they will be the subject of routine transactions in the going concern (1934: 644). This analysis clearly anticipates certain evolutionary theories of the firm that were to be developed half a century later, without any apparent initial link with the theses put forward by Commons.

### ***Collective action and 'common law method'***

For Commons, the concept of institution derives its meaning from the categories of going concern, working rules and collective action. The British and American notion of 'going concern' (which has its equivalent in the German *gutgehendes Geschäft*) is central at this point. 'It is these going concerns, with the working rules that keep them agoing, all the way from the family, the corporation, the trade union, the trade association, up to the state itself, that we name Institutions' (1934: 69). What we have here, therefore, is a definition of the institution centred on the organization and its rules.

Collective action can take one of two forms: custom, in which case it is unorganized, or going concern, in which case it is organized. Commons' classic definition of the institution is, in its summary form, 'collective action

in control of individual action', but in its complete form this becomes 'collective action in restraint, liberation, and expansion of individual action' (1934: 73). This is a major originality in the proposed analysis, notably by comparison with Veblen. It places the emphasis on the fact that it is the constraining nature of the institution itself that gives it a liberating dimension for the individual, protecting him from the constraint or inequitable treatment by other individuals, and which also considerably broadens his capacity for action, enabling him to achieve much more than he would have been able to do on his own.

The creation of law by the common law method, in line with the Anglo-American tradition, is in reality merely a particular case of a principle that is universal to all going concerns, 'making new law by deciding conflicts of interest, thus giving greater precision and organized compulsion to the unorganized working rules of custom or ethics' (1934: 73). This common law method is itself a custom – had he been more of a Veblenian, Commons might have called it a 'habit'. The working rules within organizations are perpetually changing (1934: 71); they indicate what individuals may, must or are authorized to do or not to do, subject to collective sanctions that can have a moral, economic or physical character.

### ***Institutionism, temporality and futurity***

The institution therefore represents for Commons the going concern and its working rules. However, in his discussion of the 'institutionalized mind' he extends the concept to language and techniques, thus giving it an even broader acceptance:

man's mind is more than a living organism. As organism it is only a highly developed brain. This brain is a mere part of an animal organism until it has become institutionalized. Thereupon it acquires a widened scope of activity which we call mind and will. Its first institution is signs, words, numbers, speech, writing, which we call the language of words and numbers. This is a habit for the individual and a compulsory custom handed down from generations of individuals, in short, an institution. Man's other institutions are fire, tools, machinery, family, government, and so on, whose enduring repetition . . . we name *going concerns*.

(1934: 638–9)

Temporality is an essential dimension highlighted by most currents of institutional economics, since they all stress the centrality of change.

Commons goes further, however. For him even the concept of time is a construction of the institutionalized mind.

Hence man is more than organism, he is institutionism, and it is only the institutionalized mind that evolves that remarkable time-dimension of economic activity to which we give the name, Futurity. Futurity is institutional: the isolated infant and man, like an animal, would know little or nothing about it. This institutional extension of the organism's brain into remote future time is inseparable from its extension into remote space. And it is these two institutionalized extensions of brain activity that make possible the highly developed modern going concerns in industry and government which give orders around the world and to generations unborn.

(1934: 639)

Commons therefore emphasizes the link between institutions and futurity, between the institutionalization of the spirit and its 'enlargement', both in space and in time. Time is institutional. He writes:

in the futurity-dimensions of present activity, afforded by the expectations of institutions, the human organism converts future happenings into present action. . . . What we say of Time holds of Space. It is only institutionalized brains that compass the world, and they do it through the going concerns and machines that serve as instruments.

(1934: 640)

According to the pragmatist theory of action, from which Commons takes inspiration, 'futurity' thus plays a central role (Gislain, 2002, 2003). The individual acts in the light of future reality as he sees it in the current institutional framework. There is indeed a rationality of action, but it is influenced by expectations of the future, while at the same time being bounded by the current collective action. The future is marked by uncertainty, but the effect of institutions is to reduce this uncertainty: institutional economics considers a society 'whose future is frankly recognized as unpredictable but which can be controlled somewhat by insight and collective action' (1934: 107).<sup>12</sup>

### **Polanyi and the economy as an instituted process**

Karl Polanyi (1886–1964) is best known for his book *The Great Transformation* (1944), which can be regarded as a classic exposition of heterodox institutional analysis (Maucourant, 2005). In it he describes, in

particular, nineteenth-century liberalism as a dangerous Utopia, consisting of generalizing the principle of the self-regulating market by extending it to 'fictitious commodities' – labour, land and money. The destructive effects on society of this Utopia have generated a protective counter-movement which he says has led to a relative limitation on the extension of exchange.

It would be somewhat exaggerated to describe Polanyi as an institutionalist economist, as he is essentially a historian and anthropologist and traces of the German historical school or of American institutionalism are not directly to be found in his work. Even so, it is not far-fetched to align him with this tradition and the influence he has exerted on the current of original institutionalist thought since the 1950s is substantial. It is this that justifies reference to him here.

### *The forms of integration*

The economy in general represents an 'instituted process'; it is embedded and enmeshed in economic and non-economic institutions (Polanyi, 1957: 250). In order to study the different modes of institutionalization seen at different periods in history and in different societies, Polanyi adopts the concept of 'forms of integration'. These 'designate the institutionalized movements through which the elements of the economic process – from material resources and labour to the transportation, storage and distribution of goods – are connected' (Polanyi, 1977: 35). The notion of integration is close to that of co-ordination, involving in fact the 'reunification' of what the division of labour has separated. Basing himself on a vast comparative study of historic economic systems, the author states that in this field there are three fundamental models: reciprocity, redistribution and exchange.<sup>13</sup>

Reciprocity denotes movements between correlative points of symmetrical groupings; redistribution designates appropriational movements toward a centre and out of it again; exchange refers here to vice-versa movements taking place as between 'hands' under a market system. Reciprocity, then, assumes for a background symmetrically arranged groupings; redistribution is dependent upon the presence of some measure of centrality in the group; exchange in order to produce integration requires a system of price-making markets. It is apparent that the different patterns of integration assume definite institutional supports.

(Polanyi, 1957: 250)

These forms of integration do not constitute 'stages' of development, nor are they economic systems as such. In the course of history they have

been combined in different ways: 'several subordinate forms may be present alongside the dominant one, which may itself recur after a temporary eclipse' (1957: 256). All the systems that existed up to the end of feudalism in Western Europe 'were organized either on the principles of reciprocity or redistribution, or householding, or some combination of the three' (Polanyi, 1944: 85). The system of the market economy or capitalism is, on the contrary, dominated by exchange, which tends to become exclusive.

Note that Polanyi's theory can be regarded as among the principal sources of the institutionalist theses that place the emphasis on the diversity of modes of co-ordination that coexist in an economic system (Hollingsworth, Boyer, Kornai), unlike the theories of economic co-ordination that call on essentially dualistic models (market/State or market/organization).

In contrast to Adam Smith, who postulated man's 'propensity to barter, truck and exchange one thing for another' as being the origin of the market (but also, one might add, in contrast to Veblen, who posited instincts as forming the basis for habits), Polanyi is critical of the idea that 'individuals acts and attitudes simply add up to create the institutional structures that support the forms of integration' (1977: 37). Hence, neither reciprocity nor exchange is possible 'without the prior existence of a structure pattern which neither is nor can be the result of individual actions of mutuality or barter' (1977: 37). Polanyi refers at this point to Durkheim, Weber and Pareto, who stressed the social pre-conditions for the various types of individual action. He bases himself in particular on the work of the anthropologists Thurnwald and Malinowski, which makes it possible to understand why individual behaviour does not often have social effects in the absence of given social conditions.

Only in a symmetrically organized environment will reciprocative attitudes result in economic institutions of any importance; only where centers have been established beforehand can the co-operative attitude of individuals produce a redistributive economy; and only in the presence of markets instituted to that purpose will the bartering attitude of individuals result in prices that integrate the economic activities of the community.

(1977: 38)

Polanyi therefore suggests a structuralist-type approach in which previously established institutions guide individual behaviour towards the constitution of specific forms of integration.

***Problematical 'disembeddedness'***

One of Polanyi's best known theses is that of the 'disembeddedness' of the economy with regard to society as a whole in the period of modern capitalism.<sup>14</sup> Basing himself on Aristotle, he defines the 'substantive economy' as being that of activities aimed at ensuring human subsistence (livelihood) in general. He says that the move to the domination of a system of self-regulating markets has historically been accompanied by a 'disembedding' or relative autonomization of the economy, unlike all previous economies, which were inserted into society and in which economic activities and motivations were closely integrated into social practices and purposes (parental, political, religious, etc.). As long as reciprocity and redistribution predominate, even the concept of the 'economy' as an autonomous aspect of life cannot really exist (Polanyi, 1968: 84). The profit objective that is at the basis of the system of self-regulating markets leads, on the contrary, to the domination of a 'formal' conception of the economy that is distinct from the traditional concept of the substantive economy. The economic sphere now seems to be driven entirely according to its own laws. Society becomes subordinate to the market: 'instead of economy being embedded in social relations, social relations are embedded in the economic system' (Polanyi, 1944: 88). Polanyi, who was an advocate of democratic socialism, hoped that the 'great transformation' that was taking shape after the Second World War would make it possible to limit the destabilizing disembedding of the economy and achieve a more desirable balance in the combination of the forms of integration consisting of reciprocity, redistribution and exchange.



### 3 The Austrian school and ‘ordoliberalism’

#### **Menger: the organic and pragmatic approaches**

Carl Menger (1840–1921), the founding father of the Austrian school, introduced a particularly important distinction between two different ways in which institutions are formed, in response to the criticisms of the German historical school that traditional political economy ignored the role of institutional factors for human action. Certain social phenomena ‘are the results of a *common will* directed toward their establishment (agreement, positive legislation, etc.) while others are the unintended result of human efforts aimed at attaining essentially *individual* goals’ (Menger, 1883: 133). The first are of ‘pragmatic’ origin, the second of ‘organic’ origin. If most contemporaneous institutions were set up in pragmatic ways, in a collective and deliberate manner, their analysis or their interpretation poses no particular difficulty. The same is not true, however, of institutions formed organically, whose importance for economic theory is underlined by Menger.

#### ***Money as an organic institution***

In his *Principles (Grundsätze, 1871)*, Menger formulated the theory that money originated as the unintended effect of actions of individuals wanting to improve their situation. Money was the culmination of a social process that constituted ‘the spontaneous outcome, the unpremeditated resultant, of particular, individual efforts of the members of a society’ (Menger, 1892: p. 250). In his *Investigations (Untersuchungen, 1883)*, he generalizes this theory to numerous other institutions such as law, language, markets, the origin of communities and of the State itself. The problem which ‘exact research’ in economics and in the social sciences has to solve is to understand ‘how institutions which serve the common welfare and are extremely important for its development come into being without a *common will*

directed toward establishing them' (1883: 146). Just as money arises involuntarily from interested individuals' attempts to overcome the difficulties of barter by acquiring commodities with a high degree of 'exchangeability', new localities develop as individuals of different professions and different abilities settle in new areas where they believe they will have a better market for their various skills. States come into being as families living in close proximity to each other decide that it is to their advantage to unite. What we have here is 'organic development', in which social institutions are the unconscious consequence of human actions directed towards personal ends. Some individuals will be quicker or more competent than others in promoting their interests by following certain rules or using certain means and, according to Menger, other individuals will then see their successes and try to imitate them. This is the way in which 'institutions serving the common welfare' come to be definitely established without having been planned or conceived by any individual for the purpose. For example, the case in which the knowledge that certain individuals acquire of the advantages they can obtain by accepting in exchange for their commodities other goods that have a greater 'exchangeability', even if they are of no use to them in themselves, can become more widespread.

This knowledge will never arise simultaneously with all members of a national group. Rather, at first only a number of economic subjects will recognize the advantage accruing to them. . . . (T)here is no better means to enlighten people about their economic interests than their perceiving the economic successes of those who put the right means to work for attaining them.'

(1883: 155)

Menger says that this explanation can be widely generalized and that this increases its interest: 'The methods for the exact understanding of the origins of the 'organically' created social structures and those for the solution of the main problems of exact economics are by nature identical' (1883: 158–9). Such methods were later to be described as 'methodological individualism' (the term is Schumpeter's), combined with an explanation that indirectly recalls Adam Smith's 'invisible hand', in other words a process that is not consciously implemented by the actors and which generates a result that is collectively beneficial as the paradoxical, but fortunate, result of individual actions directed towards private interest. The question that then obviously arises is whether organic institutions that are 'perverse' or even 'imbecile' (as Veblen would call them) could not take shape spontaneously. Menger admits that it is not uncommon to see that customary law (of organic origin) turns out to be harmful to the common welfare, thus justifying that it be

changed by legislation (of pragmatic origin) (1883: 233). On the whole, however, he remains opposed to ‘unilateral rationalism and to the pragmatism of the Anglo-French period of Enlightenment’, to which Adam Smith and his disciples belonged and which in his view neglected the organic origin of numerous institutions and led to excessive reformism, involuntarily opening the way for socialism (1883: 173, 177).

### *A complex interaction*

It must be stressed that the individualist approach and the analogy with the invisible hand are, in Menger’s case, linked to his economic liberalism. However, he does not raise the distinction between institutions of organic and pragmatic origin to the level of a dichotomy: ‘for the understanding of social phenomena in their entirety the *pragmatic* interpretation is, in any case, just as indispensable as the ‘organic’’ (1883: 135). The same is even true of money and law, although in these cases the organic approach predominates:

Money has not been generated by law. In its origin it is a social, and not a state institution. Sanction by the authority of the state is a notion [originally] alien to it. On the other hand, however, by state recognition and state regulation, this social institution of money has been perfected and adjusted to the manifold and varying needs of an evolving commerce, just as customary rights have been perfected and adjusted by statute law.

(1892: 255)

Going further, Menger states that the most general pattern in history is the one in which an institution initially emerges organically and is later consolidated (or distorted) by the pragmatic intervention of legislation. This is true, for example, of the present system of money and markets, law and the modern State. These are ‘examples of institutions which are presented to us as the result of the combined effectiveness of individually and socially teleological powers, or, in other words, of ‘organic’ and ‘positive’ factors’ (1883: 158).

Two levels are in fact distinguished in Menger’s theory of the origin of institutions. First, there are the individual teleological actions, intended to serve personal interests but unintentionally generating institutions of organic origin that serve the common welfare, through imitation. Second, there are the social teleological actions, aimed at serving the common welfare and deliberately producing institutions of pragmatic origin. However, the

two levels are not independent of each other, since pragmatic actions can improve institutions that have previously been formed organically.

## **Hayek's 'orders' and 'rules'**

### *The institutions of liberty*

Friedrich Hayek (1899–1992), along with von Mises, played a leading role in the preservation and extension of the Austrian tradition in the twentieth century. His work is devoted to the refoundation of economic and political liberalism and this would lead him gradually to distance himself from the common elements that the Austrian school had initially shared with the neo-classical tradition, such as the reference to equilibrium, the assumption of perfect knowledge and the central role played by prices, while at the same time preserving and deepening methodological individualism. His criticism of socialism, and more generally of interventionism, would lead him progressively to place the emphasis on the questions of co-ordination of actions in a context of complexity, relative ignorance and fragmentation of individual knowledge and to characterize competition as a process of discovery. In his writings between 1960 and 1980, especially *The Constitution of Liberty* (1960), *Law, Legislation and Liberty* (1973–79) and *The Fatal Conceit* (1988), he constructs an elaborate theory of the rules that can be considered as making an important contribution to institutional economics in the broad sense.

The concept of institution is closely linked to the notions of 'order' and 'rule' that Hayek was to develop, based on various intellectual traditions forming part of different disciplines – economics, law, political theory, psychology and philosophy – and which gave his work considerable scope. Two important sources of his vision are Adam Smith's notion of the invisible hand (and those of his predecessors in the 'Scottish Enlightenment' like Ferguson) and the distinction made by Menger between organically and pragmatically generated institutions, a distinction that he would enlarge upon and apply to 'orders'. Like Menger, his favourite examples of institutions are language, money, morality and the State, but also ownership and especially law. He also classifies orders among institutions.

### *Orders and rules*

The concept of *order* evokes a certain coherence and permanence, somewhat resembling the notions of 'system', 'structure' or 'pattern' (Hayek, 1973: 42). In the social and economic field, it is Hayek's view that it is essential to distinguish orders that are deliberately constructed or *made*, in other words

*organizations*, from spontaneous orders that have been formed and have *grown* by non-directed evolution, through a process of self-organization. The organized and spontaneous orders coexist at different levels of the economy and of society. But the extended and complex orders are not susceptible to being organized. This is particularly the case, for the two preferred examples of Hayekian theory, the order of the market and that of society as a whole.

There is therefore an essential difference, or even a major contrast, between the organization and spontaneous order. Organized order is relatively simple: it has objectives, a management that formulates directives and lays down rules and the co-ordination of its actions is conscious and deliberate. Spontaneous order is, conversely, complex, has no organizer, manager or planner, has no end-purpose and the co-ordination of actions operates in an unconscious but effective manner. Organized order is concrete, spontaneous order is abstract. It is impossible to understand the latter in intuitive fashion. To do this it is necessary to reconstitute mentally the various relations that exist between its component elements (Hayek, 1973: 44).

The two types of order have in common that they are based on *rules*. However, two differences between them have to be underlined: the organization is governed both by instructions from its managers and by rules the latter have laid down, these directives and rules being linked to the aims of the organization, while the spontaneous order is based on ‘rules of just conduct’ only. Moreover, the rules of the organized order are markedly different from those of the spontaneous order. The former have a finalized character that one might call teleological; they are concrete, deliberately established and prescriptive in nature. The latter are not directed towards aims; they are abstract because they are independent of circumstances, they are formed spontaneously and in evolutionary fashion and have an essentially prohibitive character. The contrast between these two types of order and the corresponding two types of rule is summarized in Table 3.1.

The central argument in favour of liberalism and against socialism – or indeed any kind of ‘constructivism’, in other words any ultra-rationalist pretension to reconstruct society or the economy according to organized plans – is based on the principle of the ‘superiority of spontaneous formations to central direction’ for any complex order (Hayek, 1988: 123). In fact, only non-deliberate co-ordination carried out in a spontaneous order has the capacity to process in a non-centralized manner all the knowledge or information dispersed in fragmented fashion throughout the system. For Hayek,

Table 3.1 Hayek's two kinds of orders and rules

<i>Organized orders (Taxis)</i>	<i>Spontaneous orders (Kosmos)</i>
Made order, artificial or exogenous order, arrangement, construction, organization	Grown order, self-generating, self-organizing or endogenous order
Simple	Complex
Have a direction, an organizer	Have no direction, no organizer
Aim at concrete purposes, at a goal	Independent of any common purpose (other than order itself)
Deliberately co-ordinated	Co-ordinated in an unconscious and non-planned manner
Governed by commands and by rules (subsidiary to commands, linked to purposes)	Governed by rules of just conduct
Concrete (can be intuitively perceived)	Abstract (cannot be intuitively perceived; permanent)
<i>Rules of organization</i> (Thesis: the law of legislation)	<i>Rules of spontaneous orders</i> (Nomos: the law of liberty)
Finalized (aim at concrete and predictable results in the short term)	Non-finalized, purposeless character
Concrete	Abstract (apply in an indeterminate number of future cases, without consideration of consequences)
Deliberate creation	Spontaneous emergence and evolution, gradual and marginal deliberate perfection
Differ for the different members of the organization	Are identically applicable for all
Prescriptive	Prohibitive or negative

Sources: (Hayek, 1973; 1976).

it is impossible, not only to replace the spontaneous order by organization and at the same time to utilize as much of the dispersed knowledge of all its members as possible, but also to improve or correct this order by interfering in it by direct commands. Such a combination of spontaneous order and organization it can never be rational to adopt. (1973: 59–60)

***Rules, division of knowledge and transmission of knowledge***

Although Hayek formulates a general theory of rules, he is mainly interested in those that correspond to the spontaneous order, recalling Menger's organic institutions. Indeed, one finds in Hayek's argument the individual explanation and a process of the 'invisible hand' type. However, Hayek particularly emphasizes the crystallization of knowledge based on the experience of innumerable generations that gives value to 'evolved' rules, knowledge which the individuals following these rules can therefore mobilize indirectly and, in most cases, unconsciously. Individual knowledge is in fact not only fragmented in space, but also dispersed in time, with no one person able to assemble and use all of it directly (especially not a central body); the rules of just conduct make it somehow possible to benefit from this knowledge without knowing it. This is why rules can be described as tools or instruments; for the individual rules 'are instrumental, they are means put at his disposal, and they provide part of the data which, together with his knowledge of the particular circumstances of time and place, he can use as the basis for his decisions' (Hayek, 1960: 151). Hence the importance of tradition, wrongly scorned by constructivists in general.<sup>1</sup>

One of the virtues of the abstract rules of a complex order is the ability to facilitate the adjustment of the various expectations of individuals formulating different plans of action (Hayek, 1973: 117). In this way there occurs a co-ordination through rules that complements (or perhaps even underlies) co-ordination through prices (Fleetwood, 1995). But the essential role of rules of just conduct is to enable global spontaneous order, which, in a way, is an 'emerging' and hence counter-intuitive phenomenon:<sup>2</sup> one has to 'distinguish clearly between the regularities of individual conduct which are defined by rules and the overall order which will result from the observance of certain kinds of rules' (Hayek, 1973: 111).

***The State and the law***

The basic model to which Hayek refers in his theory of law is the Anglo-American tradition of 'common law', which in his eyes is the only model that really conforms to the liberal ideal, in contrast to the 'continental' legal traditions (those of France and Germany), consisting of enacted law, which he regards as typically constructivist. He says that 'the ideal of individual liberty seems to have flourished chiefly among people where, at least for long periods, judge-made law predominated' (1973: 94). His interpretation, which has sometimes been described as romantic Anglophilia (O'Brien, 1998), is nevertheless distinctly different from that of Commons on this point, although in both cases it is in a way a question of the 'common law method'.

There are two types of law: the first is the *nomos* of the Greeks, in other words law founded on ancestral rules that bind the legislator and have to be discovered; the second type is *thesis*, which consists of 'enacted' rules that are established or laid down by an authority. The two types are often brought together under the single description of 'law' or legal rules, which amounts to confusing the rules of just conduct belonging particularly to spontaneous order and the finalized rules of organization. For Hayek, who is opposed to legal positivism, law in the sense of rules evolved from custom or tradition predates legislation. The latter, according to the common law model, will conform to its role of formulating abstract rules of just conduct if it is based on good customs and strengthens them. If, on the contrary, it proceeds *a priori* in a rationalist and constructivist spirit implying the existence of an omniscient legislator aiming at objectives of an organizational type, it will endanger the spontaneous order of the 'Great Society'.

The State therefore has a dual mission and a dual character. On the one hand, its role is to formalize and sanction rules of just conduct that are 'discovered' by the judicial process of common law, as well as, where necessary, to perfect or adjust them (this point was already accepted by Menger), but at the same time absolutely respecting their general and abstract character and their function in the maintenance of the spontaneous order of society; in other words, the State has to be the guardian of the *nomos*. But on the other hand, it is itself an organized order, based on finalized rules and internal commands, especially in its role as provider of certain public services. The State is one organization among many, no doubt the largest of the organized orders (a thesis that seems to echo that of Commons), but its dual role lies in the particular function of this specific organization with regard to the spontaneous order that transcends and contains it. The authentic Legal State ensures the observance in the global society of the abstract rules of *nomos*, that is to say the civil or 'private' law emanating from common law, while at the same time having its own internal rules of organization, which relate to *thesis* with 'public' law (Nemo, 1988).

The confusion between these two functions of the State is, in Hayek's view, one of the errors inherent in the constructivist and socialist traditions, which tend to see society as a large organization and consequently confuse *nomos* and *thesis*. These traditions therefore encourage untimely interventions in the spontaneous order and in so doing not only compromise its reproduction but also inevitably generate perverse effects leading to further corrective interventions, so running the risk of leading society in the end down *The Road to Serfdom* (1944). Classical liberalism is in this way reaffirmed, on the basis of an integration of its economic dimension (the spontaneous order of the market or 'catallaxy') with its political dimension



(personal freedom), based on an ambitious theory of institutions having at its core morality and law.

### ***Cultural evolution***

If Hayek's ideas can be considered as forming part of institutional economics, it is also because of the importance he attaches to the question of the genesis and evolution of institutions. One finds in his work, somewhat as in Veblen's, the articulation of different levels or processes of change. He in fact underlines the difference between three distinct modes of rules formation, which have led to the superimposition of three levels of rules.

There is, of course, in the first instance, the solid, i.e. little changing foundation of genetically inherited, 'instinctive' drives which are determined by [man's] physiological structure. There are then all the remains of the traditions acquired in the successive types of social structures through which he has passed – rules which he did not deliberately choose but which have spread because some practices enhanced the prosperity of certain groups and led to their expansion, perhaps less by more rapid procreation than by the attraction of outsiders. And there is, third, on top of all this, the thin layer of rules, deliberately adopted or modified to serve known purposes.

(1979: 160)

The Veblenian trilogy of instincts, habits and institutions (which Hayek does not discuss, clearly despising Veblen) is replaced by a triptych that is also a sequence: instincts, organic rules, pragmatic rules (to borrow Menger's terminology). Where Veblen saw conflicting instincts opposed in various institutional configurations and seemed at times to be interested in those that permitted beneficial instincts like the instinct of workmanship or the parental bent to predominate over negative instincts, Hayek mistrusts 'atavistic' instincts such as solidarity and altruism, which are suitable for small primitive groups but quite unsuitable for a complex extended order,<sup>3</sup> just as he also has reservations regarding reason when it does not recognize the incompressible part of human ignorance. This explains his attachment to the second level of the triptych, that of tradition founded on rules that have survived evolution; his position on this point seems opposed to that of Veblen, who insisted on the frequent archaism and maladaptation of inherited institutions. It is a fact

that neither what is instinctively recognized as right, nor what is rationally recognized as serving specific known purposes, but inherited

traditional rules should often be most beneficial to the functioning of society, is a truth the dominant constructivistic outlook of our time refuses to accept.

(1979: 162)

The genesis and destiny of rules of just conduct are interpreted by Hayek in terms of 'evolution' – a concept which in his eyes is twin to that of spontaneous order and which was to take an increasing place in his later work, in the form of *cultural evolution*. This shows analogies with other evolutionary processes, notably in the field of biology, but it has certain irreducible specificities. In particular, it is based on a method of selection that is neither natural nor artificial, but indeed 'cultural'. This process of selection concerns not individuals (as social-Darwinism imagines), but rules, and operates through the 'selection of [social] groups'<sup>4</sup> (1979: 171). Rules of conduct are originally individual innovations that may possibly spread when they are adopted by larger groups, generating distinct cultural traditions (1973: 90). Later, on the basis of relative prosperity and the expansion of different groups (demographic expansion, incorporation of strangers), the rules of successful groups will be imitated by certain others, contributing as a result to the extension of the rules of conduct in question, while the groups adhering to rules that are less favourable to their reproduction will decline or be absorbed by the former. The process of individual innovation (which is in fact initially a transgression of pre-existing rules) goes on continuously, but the cultural selection that operates as 'winnowing and sifting', depending on the differential advantages acquired by the groups (1979: 186) in the end enables the rules that are more beneficial to the global spontaneous order to survive and take root.

In reality, this theory is based on a certain interpretation of the primitive evolution of social groups. It may seem highly romantic and contrary to vast portions of the historic experience of humanity, which is marked especially by conquest and violence. Are the constructivist tendencies and the corresponding rules, characteristic of the modern era, which are denounced by Hayek, not themselves also spread by being imported or progressively imitated, with no simple and immediate relationship to the economic or demographic success achieved by the various societies concerned? It remains that, for Hayek, the rules of morality and the institutions of property, money and law (in its deepest sense) are the result of this cultural evolution that produces civilization and economic expansion. In Hayek's view the remarkable thing about the rules of just conduct (which is nevertheless equivocal and the source of errors of comprehension) is that their beneficial role cannot be understood until the 'abstract', spontaneous order is mentally reconstituted.

The individual may have no idea what this overall order is that results from his observing such rules as those concerning kinship and inter-marriage, or the succession of property, or which function this overall order serves. Yet all the individuals of the species which exist will behave in that manner because groups of individuals which have thus behaved have displaced those which did not do so.

(1967a: 70)

## **Eucken and ‘ordoliberalism’**

The theory of order (*Ordnungstheorie*), associated with the names of Walter Eucken (1891–1950), Franz Böhm and the Freiburg school, can be regarded as a contribution by German thinkers to institutional economics. Eucken tried to go beyond the cleavage resulting from the *Methodenstreit* between the institutional approach of the historical school and the emphasis put on abstract analysis by the marginalist and Austrian traditions.

### ***Economic order, property and planning***

Through recourse to a method known as ‘isolating abstraction’, as distinct from generalizing abstraction, Eucken attempts to identify, in the course of history, recurring forms of economic order (*Wirtschaftsordnung*). The result is a morphology of ‘pure types’ in which the centrally planned economy (*Zentralverwaltungswirtschaft*) is opposed to the exchange economy. The former is subdivided into two forms: the economy of individual exploitation, in which the head of the economic unit plans the activity, and the centrally administered economy, in which an administrative body carries out the planning. The latter itself comes in two forms, the barter economy and the money economy (Eucken, 1940). These two main types and their various forms are further divided into ideal sub-types, for example various forms of market in the case of the exchange economy. The extreme variety of economic systems in history can be divided into a limited number of pure forms of economic order.

For Eucken, the principal criterion distinguishing the main economic orders is not ownership, but the distribution of planning power (right of disposal). For example, Soviet Russia and Nazi Germany represent two different types of centrally planned economy, the first based on collective ownership of the means of production and the second on private ownership. If one classifies the theories of the major economic systems into those giving precedence to the criterion of ownership and those highlighting the criterion of co-ordination, Eucken’s preference is clearly for the latter. Kornai (1992) has tried to combine the two criteria, although maintaining

primacy for ownership (in conformity with the Austrian tradition going back to von Mises).

### ***The State as guardian of the competitive order***

The *ordoliberalism* of the Freiburg school differs from Manchester school liberalism (but also from Hayek's vision of spontaneous order resulting from an evolution process) in the importance it attaches to the State as 'guardian of competitive order' (Eucken, 1952: 327). While giving precedence to the freedom of economic agents, it places the emphasis on the constitutional rules of the economy that generate an economic order within which this freedom can be beneficially deployed. The parallel with Hayek's views is clear in this respect (Hayek was in fact a professor at Freiburg in the 1950s), but Eucken leans towards what might be called 'liberal constructivism' from a Hayekian perspective.<sup>5</sup> Where Hayek sees as conditions for market order 'rules of just conduct' built up by long-term evolution and cultural selection, Eucken insists on the deliberate establishment of constitutional rules by the State as a precondition for the existence and maintenance of a competitive liberal order.

Because the economic and social order is based on rules and institutions, the *Ordnungspolitik* is a policy centred on the legal and institutional framework, which one might describe as 'institutional policy'. Competition cannot be developed and maintained spontaneously, with the role of the State limited to guaranteeing property rights. Left to itself, it tends to be undermined by monopolistic tendencies and interest groups. It is for the State to ensure the establishment and maintenance of competition.<sup>6</sup>

### ***Constitutive and regulatory principles***

The economic exchange order, which is the desirable form according to Eucken, thus does not become established spontaneously, but has to be instituted and protected by the legal State. The 'policy of order' must be based on a hierarchy of principles, distinguishing between constitutive principles and regulatory principles. 'The constitutive principles are principles of the economic constitution. Their common enactment in the concrete historical situation accounts for a certain, deliberate economic order (or system) by creating conditions from which this system will develop' (Eucken, 1952: 289). These constitutive principles are as follows: the primacy of monetary policy permitting the stability of the currency on the basis of fixed rules; open markets; private ownership; freedom of contract; liability (unlimited) of firms and households; and stability of economic policy. The regulatory principles, for their part, have to be

subordinated to the constitutive principles. This is the case for the policy of combating monopolies and cartels, which must be implemented by an independent monopolies bureau, for progressive taxation, which must achieve a certain degree of redistribution, for the correction of negative externalities and for the management of the labour market.

The German doctrine of the 'social market economy' (*Soziale Marktwirtschaft*, Müller-Armack) was to prolong the ordoliberal tradition but at the same time modified it by accepting broader forms of redistribution.<sup>7</sup> The draft European constitutional treaty (2004) has combined the influence of contemporary economic neo-liberalism, mainly of Anglo-Saxon origin, and that of the social market economy (and, in the background, German ordoliberalism). For a writer like Vanberg (1994), the Freiburg school is in certain respects a predecessor of Buchanan's constitutional economy, in which the rules of rational choice are applied to constitutional rules in a liberal spirit.

## 4 The new institutional economics

### Williamson and the mechanisms of governance

Oliver Williamson is the inventor of the term ‘new institutional economics’, which from the 1990s on came to refer to various active theoretical currents, united by the idea that ‘institutions matter’ and that these can be analysed with the instruments of standard economic theory – with certain adjustments. This expression, introduced in his book *Markets and Hierarchies* (1975: 1) undoubtedly implies a certain relationship with the ‘old institutional economics’, but his criticism of the latter remains much as it was in the neo-classical tradition.<sup>1</sup>

### *The market, the firm and transaction costs*

One of the essential themes through which institutions have been reintroduced into the new institutional economics is that of the *organization* (essentially the firm, or in Williamson’s terminology, the ‘hierarchy’). In an article that was to become belatedly famous, Coase (1937) emphasized the absence of explanation concerning the existence of the firm in conventional economics. This explanation actually lies in the ‘costs of using the price mechanism’ or the ‘operation of a market costs’. These costs relate to the search for appropriate prices and to the negotiation of separate contracts. When these costs are high, an individual may choose to work in a firm, placing himself voluntarily under the authority of an entrepreneur rather than selling his services or his products directly on the market. In this way, ‘market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production’ (Coase, 1937: 388). In this case, the firm replaces the market, permitting the ‘economizing’ of the costs involved in the determination of prices. However, as firms grow in size, a countervailing movement of increasing costs of direction and management will make itself felt.

We have here an essential source of the concept of ‘transaction cost’ that Williamson was to develop. Note that the ‘transaction’ as a basic analytical unit is explicitly borrowed from Commons. The principal ‘institutions of capitalism’ considered are the market and the hierarchy (the firm, the enterprise),<sup>2</sup> to which the author adds ‘hybrid forms’ consisting of durable relations between enterprises, described as ‘relational contracting’ (subcontracting, partnerships, alliances of various kinds) (Williamson, 1975).<sup>3</sup> The question posed is that of the ‘choice’ of organization: should the various types of transaction be made through the market or through the hierarchy? These institutions constitute alternative ‘governance structures’.

### *The comparative efficiency of different modes of governance*

It will be seen that the analysis of institutions is in this case concentrated mainly on the comparative (static) efficiency of the different forms of organization in relation to the market, at a micro- or meso-economic level, being considered as ‘institutional arrangements’ whereas broader questions (custom, law, politics) fall into the category of the ‘institutional environment’. We have here indeed a theory of institutional economics centred on the organization. Although the market is itself described as an institution, its analysis in this respect is not really developed.

Williamson takes the reflection initiated by Coase concerning the existence of the firm a stage further. His approach shows clearly that what is involved here is a criticism from the standpoint of the neo-classical tradition, calling into question certain of its assumptions. He supposes, metaphorically speaking, that ‘in the beginning there were markets’ and goes on to state that firms sprang up from the market by differentiation, because of the importance of transaction costs (1975). These transaction costs are not taken into account in the neo-classical context, which considers only production costs. The author also distances himself from the neo-classical school by introducing his notion of ‘bounded rationality’ (partly borrowed from Simon) and his thesis of ‘opportunism’. ‘Contractual man’ differs from ‘economic man’ in that he is ready to lie and cheat to defend his interests. Added to the importance of ‘asset specificity’, these are the essential causes of the variable importance of transaction costs. These assumptions are also presented as differing from neo-classical assumptions.

What remains of neo-classical assumptions, however, is the efficiency-based approach: ‘transaction cost economics maintains the rebuttable presumption that organizational variety arises primarily in the service of transaction cost economizing’ (Williamson, 1985: 387). Williamson therefore explicitly excludes theories that try to explain the hierarchy in terms of power, such as Marglin’s ‘radical political economy’.

Contrary to earlier conceptions – where the economic institutions of capitalism are explained by reference to class interests, technology, and/or monopoly power – the transaction cost approach maintains that these institutions have the main purpose and effect of economizing on transaction costs.

(1985: 1)

In particular, the author retains from Simon-style ‘bounded rationality’ the limitations encountered by the agent as regards access to information and the treatment thereof; what he does not retain is the calling into question of the neo-classical assumption of maximization, through ‘satisficing’. In fact, the minimization of transaction costs clearly relates to a logic of maximization (in the broad sense), which is clear in the concept of economizing.

Table 4.1 The various theories of institutional economics as seen by Williamson (2000)

<i>Theory</i>	<i>Level</i>	<i>Frequency (years)</i>	<i>Purpose</i>
L.1 Social theory	Embeddedness: informal institutions, customs, traditions, norms, religion	10 <sup>2</sup> to 10 <sup>3</sup>	Often noncalculative; spontaneous
L.2 Economics of property rights/ positive political theory	Institutional environment: formal rules of the game – especially property (polity, judiciary, bureaucracy)	10 to 10 <sup>2</sup>	Get the institutional environment right, 1st order economizing
L.3 Transaction cost economics	Governance: play of the game – especially contract (aligning governance structures with transactions)	1 to 10	Get the governance structures right. 2nd order economizing
L.4 Neo-classical economics/ agency theory	Resource allocation and employment (prices and quantities; incentive alignment)	continuous	Get the marginal conditions right. 3rd order economizing

*Note:* ‘Economizing’ in fact harks back to a logic of efficiency and ‘calculative purpose’, for which the author distinguishes three levels depending on whether they are applied to the (formal) institutional environment, to governance structures (institutional arrangements) or to marginal conditions.

The ‘frequency’ indicated refers to institutional change.

Williamson remarks that change seen at level 1 is spontaneous, while at levels 2 to 4 it is deliberate (in Mengerian terms, the institutions in level 1 would be ‘organic’, while institutions in the levels 2 to 4 would be ‘pragmatic’).



From the 1990s on, a considerable amount of literature based on transaction costs was developed in the wake of Williamson's new institutional economics (NIE).

### ***The intermediate position of the NIE***

In a 'stock-taking' article concerning the new institutional economics, Williamson (2000) presents two levels of this theory, situated between neo-classical economics, regarded as relevant for transactions of continuous frequency, and 'social theory', which has more validity over the extremely long term (hundreds or thousands of years). Table 4.1 shows that transaction cost theory sees itself as being close to neo-classical theory, while the economics of property rights is regarded as being close to social theory. North's theory (see below) is not directly incorporated into this table, but would logically be situated at levels 1 and 2; apart from allowing for a relatively long period of institutional evolution, to a certain extent it also distances itself more from neo-classical theory than transaction cost theory.

### **North: formal and informal institutions**

Douglass North is a particularly significant exponent of the 'new institutional economics' (NIE), in that his work as an economic historian has evolved from a fairly radical neo-classical position, placing the accent on quantitative methods of measurement in history ('cliometrics') and on reasoning based on efficiency and the maximizing rationality of individuals, to a discovery of the importance of institutions and a gradual distancing from, and even criticism of, the limitations of the neo-classical tradition. This then led him in the 1990s to develop an original form of institutionalist theory, in which

#### **North's writings involving institutions**

*Institutional Change and American Economic Growth*, (with L. Davis), Cambridge, Cambridge University Press, 1971.

*The Rise of the Western World: A New Economic History*, (with R. Thomas), Cambridge, Cambridge University Press, 1973.

*Structure and Change in Economic History*, New York, W. W. Norton & Co., 1981.

*Institutions, Institutional Change and Economic Performance*, Cambridge, Cambridge University Press, 1990.

*Understanding the Process of Economic Change*, Princeton, Princeton University Press, 2005.

the dividing line from certain themes or concepts of heterodox institutional economics in the end sometimes became somewhat blurred.

### ***The limitations of neo-classicism***

The aspects of neo-classical theory that North is anxious to retain are as follows: the postulate of scarcity and hence of competition, the concept of choice under constraints, the microeconomic theory (including price theory) and the influence of relative prices. The principal errors of this tradition, in his view, are: it ignores institutions and time, it neglects transaction costs, the role of ideas and ideologies as well as that of the political process vis-à-vis the economy and, finally, its concept of rationality, an assumption that has to be ‘dismantled’ (North, 1994). Referring to Herbert Simon, North emphasizes the limits to the knowledge of the individual and to his capacity to process information, evoking the context of uncertainty involved in most economic and political decisions. However, like Williamson, he tends in fact to maintain the maximizing orientation, ignoring Simon’s thesis concerning ‘satisficing’ behaviour, as opposed to maximizing behaviour of the individual faced with having to make decisions.<sup>4</sup>

### **Formal and informal institutions, ‘enforcement’**

‘Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behaviour, conventions, and self imposed codes of conduct), and their enforcement characteristics’ (North, 1994: 361). Several points in this definition deserve to be emphasized: the notion of constraint, the distinction between formal and informal institutions and the allowance for the modalities of implementation or application (enforcement) of these two types of constraint. North uses the metaphor of ‘rules of the game’ to describe institutions, but from a perspective somewhat different from that of game theory.

Starting with his 1990 book, North has increasingly stressed the role of structures of belief. If the neo-classical assumption of rationality is open to dispute, this is because ‘history demonstrates that ideas, ideologies, myths, dogmas and prejudices matter’ (1990: 362). Both ideologies and institutions can be viewed as ‘classes of shared mental models’ (Denzau and North; 1994, p. 7). In situations of great uncertainty, the individual faced with making choices goes through a learning process with the help of a mental model, and then communication between individuals generates shared mental models, leading to ‘the creation of ideologies and institutions in a co-evolutionary process’ (Denzau and North 1994: 7). The reader may have

the impression of a rediscovery of a Veblenian thesis, according to which institutions are 'shared habits of thought' (Denzau and North, 1994: 20).

When North (2005) moves on to an essentially cognitive approach in the analysis of economic change,<sup>5</sup> the parallel with the 'old' institutionalism is sometimes striking, for example the idea that rules derived by a process of learning and calculation are endogenous to the institutional structure: 'much of what passes for rational choice is not so much individual cogitation as the embeddedness of the thought process in the larger social and institutional context' (2005: 24).

### ***Power versus efficiency***

In his early work, North adopted a neo-classical approach to institutions, in which the latter represented efficient solutions to economic problems. Through a progressive evolution, he then completely abandoned this approach and seemed even to reverse it by declaring that institutions are in reality based on power. 'Institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules' (1994: 360–2). As a consequence, it is exceptional to find economic markets that approximate the conditions necessary for efficiency. It is impossible to find 'political markets' that do so. The influence of the theory of public choice is palpable here. However, North reproaches public choice theory for neglecting informal institutions. Note that entrepreneurs or 'principals' nevertheless remain, in his view, utilitarian rational maximizers.<sup>6</sup>

On the subject of efficiency, North distinguishes allocative efficiency considered in the neo-classical tradition on the basis of Paretian optimum conditions from 'adaptive efficiency', a notion that he borrows from evolutionist economics (Nelson and Winter; Pelikan) and then applies to the rules that condition the evolution of an economy over time, in other words he transposes it to a macro historical level: 'It is adaptive rather than allocative efficiency which is the key to long run growth. Successful political/economic systems have evolved flexible institutional structures that can survive the shocks and changes that are a part of successful evolution. But these systems have been a product of long gestation. We do not know how to create adaptive efficiency in the short run' (1994: 367).

### ***Organizations and institutions***

Contrary to original institutional economics, North states that it is essential to distinguish institutions from organizations. 'If institutions are the rules of

the game, organizations and their entrepreneurs are the players' (North, 1990: 4–5). The rules define the way in which the game is played, while the teams try to win within the framework of these rules using strategy, co-ordination, competences and fair or foul means. Organizations are made up of groups of individuals bound by some common project to achieve objectives (1990: 4–5); these can be divided into political, economic, social and educational organizations. They are the loci where learning takes place.

According to North, the interaction between organizations and institutions is essential. The institutional framework conditions the type of organization that will be created, as it does their evolution, but in their turn the organizations will be at the source of institutional change.

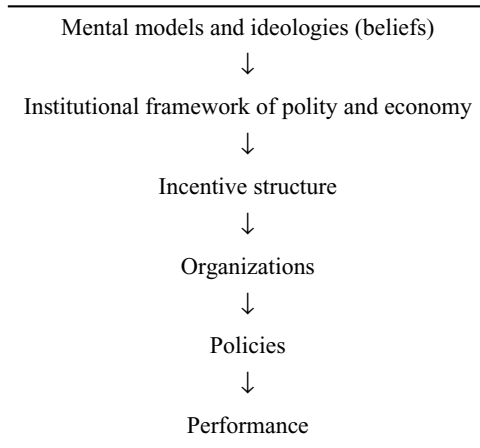
The organizations that come into existence will reflect the opportunities provided by the institutional matrix. That is, if the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities then organizations – firms – will come into existence to engage in productive activities.<sup>7</sup>

(1994: 361)

In reality, institutions always combine two opposing incentive aspects; the problem is to know how much history and context contribute to the relative weights of the two contradictory dimensions. The institutional framework is 'usually a mixed bag of institutions that promote such productivity-raising activities and institutions that provide barriers to entry, encourage monopolistic restrictions, and impede the low-cost flow of information' (1990: 64). The existing institutions therefore determine the incentives or opportunities that will benefit pre-existing organizations, or entrepreneurs, which will then create new organizations; the organizations will in their turn evolve in the established framework but will also try to modify this framework. This last 'feedback process' is of decisive importance (1990: 7); it is only by making a distinction between the two levels, institutional and organizational, that it can be understood.

### ***Institutional change***

North's institutionalist theory has a syncretic side to it, which sometimes reduces its internal consistency. The causes he attributes to institutional change are quite diverse. They can be found in changes in relative prices or preferences, or in the self-seeking activity of organizations and their entrepreneurs, but also – and this is where the difference lies – in the

*Table 4.2* The causal sequence of change

*Sources:* Denzau and North (1994); North (2005)

evolution of beliefs and mental models. In all cases, and in predominant fashion throughout history, institutional change is gradual and progressive; radical large-scale changes are rarer, consisting of war, conquest, revolution and natural disaster. The mental models also have a tendency to evolve progressively, in Darwinian fashion, over long periods, followed by briefer episodes of major change. This type of evolution recalls the ‘punctuated equilibria’ of Gould and Eldredge (Denzau and North, 1994).

Formal and informal institutions are not subject to the same time frames with regard to change. While it is relatively easy to change rapidly or even overnight in the case of the formal institutions, the modification of informal institutions takes place very gradually. This is why revolutionary transformations are never as far-reaching as their advocates would like and why the transfer or imitation of formal institutions between countries does not achieve the hoped-for results.

And economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western market economies to Third World and Eastern European economies is not a sufficient condition for good economic performance.

(1994: 366)

North cites examples from history in which various Latin American countries in the nineteenth century adopted, with certain modifications, the United States Constitution or in which a number of Third World countries transposed property legislation from successful Western countries. This transfer of formal rules has not prevented differences in enforcement mechanisms, informal rules of behaviour and the subjective models of the actors. The resulting incentive structures have therefore been unable to produce similar performance and the outcomes of the application of similar formal rules have turned out to be extremely divergent (1990: 101).

### ***Institutional matrix and 'path dependence'***

Institutions combine into a whole inherited from the past, in a given country and at a given time: this is the 'institutional matrix'. This matrix, marked by increasing (institutional) returns, will condition the incentives of organizations and individuals and, in the final analysis, influence the 'performances' of the national economy in question. North is especially interested in the comparative long-term growth of different economies. The national paths of institutional change, and hence the relative performances, are very different, as modern history shows. These paths are marked by phenomena of 'path dependence' and 'lock in'<sup>8</sup> that result from the complex interaction between organizations and institutions. Relatively inefficient paths can, for example, be persistently followed over fairly long historical periods. Indeed, according to North, this is the case most frequently found in history, while the paths consisting of lasting and cumulative growth, although possible as forms of virtuous 'lock in', are rather the exception (1990: 7–9). The trajectory followed by an economy tends to become consolidated through network externalities, organizations' learning processes and the subjective models of individuals, which are historically conditioned.

### ***Institutions and performance***

While the idea of a link between institutional matrix (or institutional reforms) and medium- or long-term macroeconomic performance seems to be common to several contemporary forms of institutionalism, North considers that it is incentives that constitute the principal mediation between institutions and performance. The institutional matrix is not limited to economic institutions, it also includes political and legal institutions; the whole network of interdependent formal and informal rules, particular to each economy, conditions its historic path-dependent evolution and its performance in terms of long-term growth.

The political system plays a decisive role because it is at this level that the formal economic rules of the game are established and their application controlled. Property rights, which define the use, income rights and transferability of assets, constitute the core of the formal economic institutions. Political systems that have led to assured and clearly defined property rights have been the source of Western prosperity. North therefore incorporates as a central thesis the theory of property rights. ‘One gets *efficient* institutions by a polity that has built-in incentives to create and enforce efficient property rights’ (1990: 140). But it should be noted that this is more a matter of allocative efficiency than of adaptive efficiency.

In *Structure and Change* (1981), North analysed the divergent trajectories in terms of economic development of France, Spain and Portugal, on the one hand, and England and the Netherlands, on the other, between the sixteenth and eighteenth centuries. The State’s permanent need of income in the first two countries led them to grant monopolies to guilds or companies and to override private property rights, the result being economic stagnation in France and economic decline in Spain. By contrast, in England and the Netherlands the interests of the merchant class generated a set of institutions that created incentives for efficient trade, thanks to the protection of property rights. Furthermore, the different attitudes of the State regarding private property were transmitted to the respective colonies. While the Spanish and Portuguese possessions in Latin America found themselves caught in a sluggish development trajectory, the English colonies in North America enjoyed lasting growth.

Such contrasting evolutions have been reproduced innumerable times in history and in the present day world, culminating in the disastrous experience of the Soviet Union.

Growth has been generated when the economy has provided institutional incentives to undertake productivity-raising activities such as the Dutch undertook. Decline has resulted from disincentives to engage in productive activity as a consequence of centralized political control of the economy and monopoly privileges. The failures vastly exceed the successes. Economic growth has been the exception; stagnation and decline have been the rule, reflecting a persistent tendency toward failure in human organization.

(North, 2005: 134–5)

### **Game theory and comparative institutional analysis**

One of the paths by which mainstream economics has discovered – or rediscovered – institutions in the recent past is through game theory.

Initially, this theory took its place in the standard paradigm of economics inasmuch as it presupposed agents that were rational, utilitarian and maximizing, it reasoned in the framework of methodological individualism and possessed an ahistoric and decontextualized character, but also because the 'rules' constituting a game were considered to be given from the start: they were exogenous.

However, the centrality of the theme of 'co-ordination' or 'co-operation' (as in the classic 'prisoner's dilemma', for example) and the taking into account of repeated games, implying a process of evolution, progressively led game theory to be linked to the question of institutions (Walliser, 1989). The analogy between the rules of the game and institutions gradually came to be accepted.<sup>9</sup> When certain games are repeated, the players tend to develop new implicit rules ('rules of thumb') and norms, conventions and 'institutions' founded on a social agreement which are passed on to successive generations of players. Such institutions then 'convey information about the expected actions of other agents' (Schotter, 1981: 109).

There is however one major difficulty with these approaches. The initial rules of the game are given at the start (they are unexplained) and condition the new rules that will emerge through processes of evolution or learning. The explanation of the genesis of institutions therefore involves a circularity of reasoning (Field, 1994), linked to the absence of a concept of hierarchy or historicity of rules, unless one is to introduce 'supergames' or 'meta-games', but this merely shifts the problem without solving it.

Even so, it remains true that game theory was to exert a major influence on certain currents of 'new institutional economics' derived from neo-classical theory and proceeding by the inflection, extension or criticism of certain of its postulates. Starting with an essentially logical reflection aimed at explaining certain predetermined economic situations, this theory is even, on occasion, applied to historic experiences or institutions. Such is the case for 'comparative institutional analysis', illustrated notably by Aoki and Greif, which sets itself the objective of comparing historic national institutions or systems. Although close to North in terms of its subject, it nevertheless differs through its recourse to game theory.

### *Aoki: institutions as shared beliefs*

Masahiko Aoki's theory is based on a conception of institutions as equilibria in the game theory sense.<sup>10</sup> Three approaches can be identified that start from an analogy with games: one sees institutions as players (large organizations), one as rules of the game (North, Hurwicz) and the other as the results of equilibrium or game beliefs (Schotter, Greif, Young – or Aoki himself). This last conception of 'institutions as equilibria' has, in Aoki's



view, the advantage of making it possible to consider the origins and enforcement of institutions as endogenous (Aoki, 2000: 141). However, as Field (1979) shows, it is not possible to envisage a model of a game deprived of institutions and consisting of purely technical rules; any game model in fact presupposes, implicitly or explicitly, pre-existing human institutions. As a result, Aoki admits that, in addition to the game theory that gives the basis for institutional analysis, it is also necessary in complementary fashion to call on historic and comparative information.

An institution is a self-sustaining system of shared beliefs about how the game is played. Its substance is a compressed representation of the salient, invariant features of an equilibrium path, perceived by almost all the agents in the domain as relevant to their own strategic choices. As such it governs the strategic interactions of agents in a self-enforcing manner and in turn is reproduced by their actual choices in a continually changing environment.

(Aoki, 2001: 26)

Various equilibria are, *a priori*, possible. Aoki identifies several aspects of his conception of the institution as ‘shared beliefs’:

- 1 The institution is endogenous, stemming from interactions among agents that will produce lasting equilibrium;
- 2 It represents a compression of information;
- 3 It is robust and survives unceasing changes in the environment;
- 4 It has universal relevance in the eyes of numerous agents;
- 5 There is a multiplicity of possible institutions in various fields of the economy and society.

An equilibrium recognized as an institution may possibly be codified and represented in an explicit manner. But this codified form will have the character of an institution only if agents collectively believe in it. For example, statutory law and regulations are not institutions if they are not followed. Take the case in which the State bans the import of certain goods but people believe that it is efficient to give bribes to customs officers to get around the law and it is this practice that comes to predominate; in this case it is the practice of bribery that has to be considered as an institution and not the ineffective legislation (2000: 13).

In his book on comparative institutional analysis (2001), Aoki examines a large number of historical or contemporary examples taken from different societies (e.g. the Silicon Valley model, the Japanese model of the principal bank, etc.). He insists on the ‘institutional complementarity’ in a national

Table 4.3 Models of institutional liaisons (complementarities) as seen by Aoki

<i>Model</i>	<i>Domain</i>	<i>Corporate governance</i>	<i>Financial institutions</i>	<i>Labour and employment institutions</i>	<i>Product market/ industrial institutions</i>	<i>Supply relationships</i>	<i>Social embeddedness/norms/values</i>	<i>State</i>
W (Walrasian)		Entrepreneurial control		Auctioneers			Utilitarianism	Liberalism
HM (Hart & Moore)		Owner control (H-M firm)	Active capital asset markets	Efficiency wage		Integration of complementary physical assets		(Liberalism)
A (American)		Managerial control	Securitization (markets of corporate control)	Employing bureaucracy, job-control unionism	Regulated oligopolistic competition	Vertical integration	Various communities	Representative democratic
D (German)		Co-determination	Committed stockholders	Corporatist regulations	Enabled trade associations	Autonomous suppliers	Industrial citizenship	Social-compact corporatism
J (Japanese)		Relational contingent governance	Main bank system	Companywide personnel control	Industrial associations	<i>Keiretsu</i> supplier	Social status gradation	Bureau-pluralism
SV (Silicon Valley)		VC-governance by tournament	Venture capital staged-financing, IPO markets	High mobility due to short life cycle of start-up firms	Clustering, standard-setting associations	Fabless-firms	Professional communities, entrepreneurial tournament	Entrepreneur-friendly
GL (global)		Market monitoring	Global corporate assets markets	Cross-border competition	Strategic alliance, e-commerce	A&D, b2b, e-commerce	Diverse NGOs	Multi-layered states

Source: Aoki, 2001, p. 379 (table condensed here)

framework or even within a given domain of the economy: ‘the effectiveness (or presence) of one exchange (property rights) governance mechanism can be reinforced, either directly or indirectly, by the presence (institutionalization) of a particular mechanism’ in the same domain or in the same economy (2001: 87). However, complementarity does not signify the optimality of institutional arrangements, just as there is no necessary optimality in the case of distinct institutions.

For Aoki, like many exponents of contemporary institutional economics, institutional diversity in different countries will not be eliminated by globalization tendencies. Moreover, such diversity – although far removed from the conditions of ideal efficiency – is beneficial. Since the various institutions interact in a competitive or complementary fashion, national conditions will continue to adjust to changes in the global and technological environment but in a path-dependent manner.

Then we will continue to see dual tendencies of global institutional arrangements toward the rising importance of supranational institutions, on one hand, and the evolving diversity of regional, national and local institutions, on the other. We believe, however, that it will be the diversity that will make the world economy more robust to unforeseen shocks and its innovative adaptations to its changing environment possible.

(2001: 393)

Aoki sets out in a comparative table (Table 4.3) three groups of models of institutional arrangements in order to highlight the complementarities. The first group comprises pure theoretical models used for reference, namely the neo-classical Walrasian model (W) and the property rights model of Grossman, Hart and Moore (HM). The second group consists of stylized national models considered before the revolution in information and communication technologies (ICT), such as the United States (A), German (D) and Japanese (J) models. The third group includes two models that are emerging in the ICT era, namely the Silicon Valley model (SV) and the global or transnational model (GL).

### ***Greif and the conjunction of rules, beliefs and organizations***

Avner Greif is a partisan of ‘historical and comparative institutional analysis’; he sees this as a means of filling the gap between the evolutionary perspective of the old institutional economics and that of the new institutional economics which mainly considers institutions that have been deliberately established<sup>11</sup> (Greif, 2006: 153).

Interesting himself especially in institutions that are spontaneous *results* and are ‘self-sanctioning’ inasmuch as they do not rely on an external sanction, he proposes an approach that considers the ‘historic process’ and combines game theory studies and empirical, historic and comparative analyses (1998). Greif accordingly compares the Genoan traders, with their individualistic culture, and the Maghrebin traders (Jews in the Muslim world), whose culture was more collectivist, two communities which were trading in the Mediterranean region in the eleventh and twelfth centuries. The latter group developed networks of communication in order to ensure collective action, which turned out, however, to be of limited efficacy for ensuring relations with traders of a different ethnic origin. The Genoan traders, for their part, established bilateral control mechanisms with a limited level of communication which led to formal and political organizations monitoring and sanctioning the established agreements, the use of such control mechanisms turned out to be more favourable to the extension of trade. Not only did the Genoan traders finally supplant the Maghrebin traders, but Greif observes similarity in terms of social organization between the latter and present-day developing countries, whereas the former group’s social organization resembles the institutions that have prevailed in Western history. This means that cultural values influence institutions and hence performance (Greif, 1994a, 1994b).

Unlike North, Greif therefore proposes a comprehensive definition of the institution as a ‘system’ that includes rules, beliefs and organizations.

An institution is a system of social factors that conjointly generate a regularity of behavior. These factors are social in being man-made, non-physical factors that are exogenous to *each* individual whose behavior they influence. The various social factors that constitute an institution – in particular rules, beliefs, norms and organizations – motivate, enable, and guide individuals to follow one behavior among the many that are technologically feasible in social situations.

(2006: 383)

Several examples of this synthetic vision are shown in Table 4.4.

Table 4.4 Institutions as systems

<i>Rule</i>	<i>Organizations</i>	<i>Beliefs and internalized norms</i>	<i>Implied regularity of behaviour</i>
Rules of the road	Departments of motor vehicles and law enforcement officials	Belief that other drivers and law enforcement officials will behave in a particular way	Driving according to the rules
Rules regulating the payment of bribes such as the amount paid, how and to what effect	State administration, police, courts of law	Belief that the response of the state, police and courts to bribe-taking renders it profitable; belief that paying the bribe is the least costly way to advance one's interest	Corruption
Rules regulating the use of credit cards and prosecution of defaulters	Credit card companies and legal authorities	Belief in the credit card company's ability to screen cardholders, impose legal punishment and damage one's credit history	Impersonal exchange without cash among sellers and holders of credit cards
Rules governing membership and behaviour toward members and non-members	Community of Jewish traders in New York	Belief in community members' ability and motivation to punish cheaters, thereby making cheating unprofitable	Exchange without reliance on legal contracts
Behavioral rule of not clearing forests	None	Internalized beliefs about retaliation by forest deities	Avoidance of forest clearing
Rules legalizing and governing slavery in the United States	White communities, state and federal legislators, legal authorities in the South	Internalized norms justifying slavery; beliefs in particular behaviour by other Whites, African Americans and legal authorities	Slavery

Source: Greif (2006, p. 38)

# 5 Contemporary European currents of thought

## Regulation theory: historical macroeconomics

The French ‘Régulation’ school is a heterodox theoretical current of thought, first developed in the 1970s, that clearly belongs to the institutionalist family. The following box lists some of the major publications that have been produced by this current.

### *The institutional forms of historical capitalism*

Regulation theory retains from the Marxian tradition the interpretation of capitalism as a mode of production, based on two fundamental relationships:<sup>1</sup> the exchange relationship between producers of commodities, both separate and yet interdependent through the division of labour, and the wage-labour nexus or the capital-labour relationship. It nevertheless sets itself apart from this tradition by refusing the thesis of immanent laws or ineluctable tendencies in the mode of production, such as the falling trend in the profit rate. The dynamic of the system is admittedly based on the accumulation of capital, as Marx had emphasized, but this accumulation is liable to experience different historic modalities, without any foreseeable end or succession of necessary stages. These ‘accumulation regimes’ are based specifically on historic institutional configurations, which depend on the national forms taken at various periods by the two fundamental relationships. The structure adopted to analyse national experiences seen over the medium-term historic period comprises five ‘institutional forms’ that have to be seen as interdependent groupings, forged in the national framework but sometimes under foreign influence, following social conflicts and compromises depending on the country’s political history.

In such an approach, institutions are essentially captured at an ‘intermediate’ level, with ‘intermediate’ having a dual meaning. First, it signifies a level intermediate between the two abstract relationships that are common

**Principal writings of the Regulation school**

- M. Aglietta, *Régulation et crises du capitalisme*, Paris, Calman-Lévy, 1976 (*A Theory of Capitalist Regulation: The US Experience*, London, Verso, 2001).
- R. Boyer, J. Mistral, *Accumulation, inflation, crises*, Paris, PUF, 1978 (2nd edn, 1983).
- A. Lipietz, *Crise et inflation, pourquoi?*, Paris, La Découverte, 1979.
- R. Delorme, C. André, *L'État et l'économie. Un essai d'explication des dépenses publiques en France 1870–1980*, Paris, Seuil, 1983.
- A. Lipietz, *Le monde enchanté. De la valeur à l'envol inflationniste*, Paris, La Découverte, 1983 (*The Enchanted World: Inflation, Credit and the World Crisis*, London, Verso Books, 1985).
- R. Boyer, *La théorie de la régulation: une analyse critique*, Paris, La Découverte, 1986 (*The Regulation School*, New York, Columbia University Press, 1990).
- B. Coriat, *Penser à l'envers*, Paris, Christian Bourgois, 1991.
- B. Théret, *Régimes économiques de l'ordre politique: esquisse d'une théorie régulationniste de l'État*, Paris, PUF, 1992.
- R. Boyer, Y. Saillard (eds), *Théorie de la régulation: l'état des savoirs*, Paris, La Découverte, 1995, 2nd edn, 2002 (*Régulation Theory: The State of the Art*, London, Routledge, 2002).
- F. Lordon, *Les quadratures de la politique économique*, Paris, Albin Michel, 1997.
- B. Billaudot, *Régulation et croissance. Une macroéconomie historique et institutionnelle*, Paris, L'Harmattan, 2001.
- B. Amable, *The Diversity of Modern Capitalism*, Oxford, Oxford University Press, 2003.
- M. Aglietta, A. Reberioux, *Les dérives du capitalisme financier*, Paris, Albin Michel, 2004 (*Corporate Governance Adrift: A Critique of Shareholder Value*, Aldershot, Edward Elgar, 2005).
- R. Boyer, *Théorie de la régulation. 1. Les fondamentaux*, Paris, La Découverte, 2004a.
- R. Boyer, *Une théorie du capitalisme est-elle possible?*, Paris, Odile Jacob, 2004b.
- B. Coriat, P. Petit, G. Schmeder (eds), *The Hardship of Nations: Exploring the Paths of Modern Capitalism*, Cheltenham, Edward Elgar, 2006.

to all historic capitalist economies and the concrete forms taken by economic relations in a given country and at a given time – in other words, it is a stylized representation of interdependent institutional groupings analysed in five domains that give an all-inclusive representation of a national economic system; second, it implies an intermediate level between long-period history

and the immediate situation: accumulation regimes and modes of regulation generally remain valid over a period of some decades. What we have, therefore, is a form of historical institutional economics that affirms the evolutionary diversity of national forms of capitalism from the nineteenth century to the present day and includes an essential comparative dimension.

A second influence on regulation theory comes from Keynesian macro-economics, or, to be more precise, from the post-Keynesian school (Lavoie, 2006) that has tried to combine Keynes' teaching with certain Marxian themes. The question of capital accumulation is therefore approached in liaison with the distribution of income, especially the relationship between profits and wages and with the problem of the adjustment of global demand and supply. A direct connection can consequently be sought between the historical institutional configurations and given forms of growth, through the mediation of specific 'accumulation regimes' and 'modes of regulation'. The accumulation regime corresponds to a pattern of regular growth, while the mode of regulation represents the procedures and social behaviour that 'support and steer' such a regime and 'ensure the compatibility over time of a set of decentralized decisions, without the economic actors themselves having to internalize the adjustment principles governing the overall system' (Boyer, 1990: 19).

On this view, the 'Fordist' accumulation regime, which became established during the exceptional period of high and relatively stable growth in the advanced countries between 1950 and the early 1970s, was based on a constellation of particular institutional forms that were nationally self-centred: a monetary regime based on credit; a wage-labour regime marked

*Table 5.1* The five institutional forms in a national economy

- 
1. Forms of monetary constraint (monetary and financial regime)
  2. Configurations of the wage-labour nexus (organization of work, skills hierarchy, mobilization and attachment of workers to the firm, formation of direct and indirect wage income, workers' way of life)
  3. Forms of competition (e.g., competitive, monopolistic, administered competition regimes)
  4. Modalities of insertion into the international regime
  5. Forms of the State (e.g., limited State, embedded State)

These forms are conceived as historic 'codifications' of the two fundamental relationships under capitalism (1, 3 and 4 constitute codifications of exchange relations, 2 represents codifications of the wage-labour nexus, 5 concerns codifications that have consequences for both exchange and wage-labour relations).

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*Sources:* (Boyer and Saillard, 2002), (Billaudot, 2001), (Boyer, 2004a)



by a post-Taylorian organization of work, sharing of productivity gains and expansion of mass consumption; oligopolistic forms of competition; and an 'embedded State' involving an extension of the Welfare State.

Among the various institutionalist currents affirming the existence of a relationship between institutions and modes of economic growth (like Douglass North's NEI), the regulation school is one of those that has gone furthest in trying to study the process underlying this relationship (Boyer, 2004a; Petit, 2005).

While they adopt an explicitly critical position with regard to the neo-classical tradition, regulationist authors have generally distanced themselves from the German historical school and American institutionalism, trying to evade the traditional (and disputable) criticism levelled against them by mainstream economists, namely that their approach tends to constitute a sort of descriptive historical sociology without any genuine theoretical foundation.<sup>2</sup> And yet the declared ambition of this current of thought to 'combine theory and history', especially in the work of the Annales school, cannot fail to recall the programme of the historical school. There is no visible link with the Austrian tradition, which it rejects for its economic liberalism.

### ***Institutions and institutionalized compromises***

Captured at a meso-economic and meso-historical level, institutions are essentially forged as 'institutionalized compromises' between social groups in conflict, and are distinct from 'authoritarian institutionalization, by public authorities' (Delorme and André, 1983). The emergence of new institutions therefore often follows crises, conflicts or wars. It takes place in the framework of the nation state inasmuch as the political sphere remains the essential setting for the formation and legitimization (or contestation) of the compromises concerned.<sup>3</sup> Admittedly, the influence or import of foreign institutions or forms of organization is by no means rare, but these are generally transformed by the constraints imposed by the national configuration. What is involved is a process of institutional or organizational hybridization (Boyer, 2004b: 197). This recalls a frequent institutionalist thesis found in the work of Veblen or North, for example.

### ***Diversity of capitalisms, complementarity and hierarchy***

Inspired by the recent work of Michel Albert (1993), a substantial amount of work in the field of institutional economics has made a deeper analysis of the long-standing comparison between various national forms of capitalism (already to be found in the work of Marx, the German historical school,

Veblen and, more recently, North), resituating it in contemporary controversies regarding globalization, convergence, the influence of the American model, etc. (Berger and Dore, 1996; Hollingsworth and Boyer, 1997; Aoki, 2001; Hall and Soskice, 2001; Crouch, 2005). Certain typologies tend to be dualistic. For example, Albert compares the Rhineland model and the Anglo-Saxon model; Hall and Soskice compare the liberal market economies and the co-ordinated market economies. Other authors propose a wider range of historical or contemporary models, depending on the objectives of the comparison being made; this is true of the researchers belonging to the regulation school.

In *The Diversity of Modern Capitalism*, Bruno Amable stresses that it is the complementarity and hierarchy of institutions that explain the diversity of models of capitalism (2003: 13). The notion of complementarity (close to that developed by Aoki) signifies that 'the existence or the particular form taken by an institution in one area reinforces the presence, functioning, or efficiency of another institution in another area' (2003, p. 60). However, this complementarity may have a contingent and relatively provisional nature. Hierarchy signifies that one or more institutions play a particular role in a given historical configuration.<sup>4</sup> On this basis, Amable distinguishes five types (or ideal types) of contemporary capitalism: market-based capitalism, social democratic capitalism, Asian capitalism, continental European capitalism, South European capitalism. Each of these types covers several national examples.

### ***Crises***

Among the originalities of regulation theory are its insistence on the heuristic importance of crises and its proposed typology of capitalistic crises: minor crises in the framework of a given mode of regulation, which tend to be resolved endogenously; and major or structural crises, which cannot be resolved without significant changes in institutional forms. This typology can be refined by ranking crises in ascending order of seriousness, leaving aside exogenous shocks: cyclical crises within a given mode of regulation, crises of the mode of regulation, crises of the accumulation regime, crises of the mode of production (Boyer, 1990). A complex interaction between institutions, growth modalities and forms of crisis is highlighted in a medium-term historical perspective.

There is recursive causality operating between the institutional framework and the modalities of economic growth. This approach has

shown how institutionalized compromises had shaped accumulation regimes, initially mainly extensive and later mainly intensive, and

finally intensive with mass consumption, i.e. Fordism. The reverse relation merits study: economic transformations shape institutions. *Structural crises* are commonly overcome through the restructuring of institutional forms, under the dual constraint of reducing prior imbalances and responding to the social conflicts that such imbalances have induced.

(Boyer 2004b: 27)

Institutional change, considered at a macro- or meso-historical level, results in the final analysis from tensions within a given configuration, generated by a situation of economic crisis and the resulting conflicts, or by a gradual shift in the balance of power between collective actors.

With regard to the notion of ‘performance’, which Northian new institutional economics reduces in practice to an economy’s long-term growth, the essential question in the regulationist approach is more that of the ‘viability’ of an institutional configuration, which is expressed by its relative capacity to surmount crises – the extreme diversity of which is emphasized. Such viability is inevitably limited to a particular historic period and is likely to be called into question sooner or later by a structural crisis. On these lines, endometabolism (Lordon, 1994), or ‘transformation of a development mode resulting from its own internal dynamics’, constitutes an essential source of institutional change; ‘it becomes all the more manifest as the time scale being observed lengthens’ (Boyer, 2004b: 197).

### **The economics of conventions: interpreting the rules**

The economics of conventions is a French theoretical school on the border between economics and sociology that was first expanded in the 1980s. It develops a theory of rules claiming to belong to institutionalist conceptions.

Starting from a reflection about the philosopher David Lewis’s book *Convention* (1969), as well as from Keynes’ views concerning the essential role of conventions in an economy marked by radical uncertainty, but at the same time distancing themselves to some extent from game theory, the conventionalist economists stand apart not only from standard (neo-classical) theory but also from ‘extended standard theory’, which includes in particular the new institutional economics of the kind put forward by Williamson which adopts a truncated version of Herbert Simon’s idea of ‘bounded rationality’, while still retaining the assumption of the optimizing individual (Favereau, 1989). But Simon’s idea of ‘procedural rationality’, which implies recourse to rules of action, should preferably be retained. However, the economics of conventions is anxious to maintain

**The principal writings on the economics of conventions**

- R. Salais, L. Thévenot (eds), *Le travail: marché, règles, conventions*, Paris, Economica, 1986.
- J.-P. Dupuy, F. Eymard-Duvernay, O. Favereau, A. Orlean, R. Salais, L. Thévenot, *L'économie des conventions*, *Revue économique*, 40 (2), mars, 1989.
- L. Boltanski and L. Thévenot, *De la justification. Les économies de la grandeur*, Paris, Gallimard, 1991 (*On Justification: Economies of Worth*, Princeton, Princeton University Press, 2006).
- B. Reynaud, *Le salaire, la règle, le marché*, Paris, C. Bourgois, 1992.
- A. Orlean (ed.), *Analyse économique des conventions*, Paris, PUF, 1994, 2nd edn, 2004.
- R. Salais, M. Storper, *Worlds of Production: The Action Frameworks of the Economy*, Cambridge, MA., Harvard University Press, 1997.
- R. Salais, E. Chatel and D. Rivaud-Danset (eds), *Institutions et conventions: la réflexivité de l'action économique*, Paris, Editions de l'EHESS, 1998.
- A. Orlean, *Le pouvoir de la finance*, Paris, Odile Jacob, 1999.
- L. Boltanski and E. Chiapello, *Le nouvel esprit du capitalisme*, Paris, Gallimard, 1999 (*The New Spirit of Capitalism*, London, Verso, 2007).
- P. Batifoulier (ed.), *Théorie des conventions*, Paris, Economica, 2001.
- B. Reynaud, *Operating rules in organizations: macroeconomic and microeconomic analyses*, Basingstoke and NY, Palgrave Macmillan, 2002.
- O. Favereau and E. Lazega (eds), *Conventions and Structures in Economic Organization: Markets, Networks and Hierarchies*, Cheltenham, Edward Elgar, 2002.
- F. Eymard-Duvernay, *Économie politique de l'entreprise*, Paris, La Découverte, 2004.
- F. Eymard-Duvernay, (ed.), *L'économie des conventions*, Paris, La Découverte, 2006, 2 vols.

methodological individualism, as opposed to the more holistic approaches of heterodox forms of institutionalism. The economics of conventions remains predominantly 'micro', notably through the interest it takes in organizations, whereas the other forms remain predominantly 'macro', although a consensus of principle exists concerning the reductionist nature of simply opposing methodological individualism and holism.<sup>5</sup>

***Conventions as institutions***

A first approach to the notion of convention consists of considering a subset of social rules, somewhat reminiscent of certain of North's informal

institutions. Convention is ‘a particular type of rule, characterized by a certain arbitrariness, most of the time not associated with legal sanctions, obscure in origin and relatively vaguely formulated or possibly precisely, but not officially, formulated’ (Favereau, 1999: 166). But where game theory in the footsteps of Lewis adopts a strategic approach to conventions, maintaining substantial (or at best, bounded) rationality, the conventions school proposes a ‘interpretative approach’ that highlights the normative dimension of conventions, the importance of representations and the procedural nature of rationality (Batifoulier and de Larquier, 2001: 22).

While formal rules, such as those of law, are therefore not conventions in this restricted sense, conventions in the broad sense cover an extremely vast field, as they also necessarily accompany formal rules, these being by their very nature incomplete. Conventional rules are therefore not only a sub-set of the totality of social rules, but also operate in conjunction with two other sub-sets: contract rules and constraint rules, such as those emanating from the legal system (Biencourt *et al.*, 2001: 213).

Standard economics admits that contracts are incomplete, since they are unable to cover, formally and explicitly, all the possible and imaginable hazards of their future application. In reality, even the formal rules of an organization or codified legal rules inevitably have this character of ‘incompleteness’. A conventional dimension is therefore present in the functioning of any rule, even a formal one, going beyond conventional rules as narrowly defined.

### ***Inter-individual co-ordination: the scope for interpretation***

Game theory has reactivated the theme of co-ordination of individual action but this time not in the traditional sense of individuals or firms that are autonomous and at the same time interdependent in the framework of a technical or social division of labour, but in the sense of co-ordination of utilitarian rational individuals faced with given local interactions (‘games’). The economics of conventions develops this theme of co-ordination, generally preserving the local approach but with a broader ambition, stressing the conventional dimension of the rules that underlie any co-ordination and the role played by interpretation of rules by individuals who are not uniquely responding to their own interests, but are concerned by the *legitimacy* of their actions.

Following the ‘cognitive turn in economics’, the conventionalist approach therefore places the accent on individual and collective representations in social relations. The individual is not a utilitarian calculator, but incorporates into his conduct a normative vision of co-ordination with others and of the ‘common good’. The nature of this ‘common good’ is nevertheless

controversial, as it depends also on the spheres of action, the 'cities' and the various principles of legitimacy.

### *The economics of worth*

In their book *De la justification*, Boltanski and Thévenot (1991) distinguish between six 'cities' present in society, each one being accompanied by a conception of what is 'right' or legitimate and an evaluation of what constitutes the 'worth' (*grandeur*) of an individual. Through disagreements or disputes, each individual tries to justify his own action by referring to a higher principle that can be interpreted as a convention. In this way, through debate or controversy, co-ordination by convention may take place. The 'cities' are not spheres or domains of activity: in a single domain of activity, different justifying principles may be combined or opposed to each other. The multiplicity of possible conventions and of the forms of co-ordination based on legitimacy rules is therefore stressed.

In *Le nouvel esprit du capitalisme* (Boltanski and Chiapello, 1999) the approach is extended from the micro to the macro level, with a more holistic and historical dimension, since capitalism, its spirit and its critique appear in it as collective actors. The emergence of a new city since the 1970s has been diagnosed in the French experience, namely the 'city of projects', related to

Table 5.2 Cities and worth

<i>Cities or worlds</i>	<i>Common higher principle</i>	<i>Worth</i>	<i>People of worth</i>
Inspired city	Inspiration	Singularity, genius, creativity	Great creators
Domestic city	Tradition, reproduction	Hierarchical superiority	Managers, bosses, parents
City of opinion	Reputation	Fame	Stars, opinion leaders
Civic city	General interest	Acting in the common good	Collective bodies (parties, bureaus)
Exchange city	Competition	Ownership of goods desired by others	Businessmen, salesmen, clients, wealthy people
Industrial city	Efficiency, performance	Expertise, application of operational methods	Professionals, specialists, people with responsibility

Source: (Boltanski and Thévenot, 1991)

the notion of network in which the higher principle is the capacity to manage or participate in projects and the manager or project leader is the typical representative of worth or greatness. New disputes, new compromises and new conventions then result.

### ***The multiplicity of forms of co-ordination***

The central question of the co-ordination of individual actions is tackled by conventionalist thinkers through a pluralistic approach – reminiscent of, but without explicitly mentioning, the approaches of Commons, Polanyi or economic sociology. Various modes of co-ordination coexist in organizations such as firms, or in the global economy, giving rise to compromises that can be interpreted as ‘rules equilibria’. Taking three significant modes of co-ordination, Favereau and Thévenot (1996) make a comparison of their various dimensions in the table below.

*Table 5.3* Principal specifications of forms of co-ordination

<i>Form of co-ordination</i>	<i>Exchange</i>	<i>Industrial</i>	<i>Domestic</i>
1. Method of evaluation (worth)	Price	Performance, efficiency	Reputation
2. Common objects	Traded goods	Technical objects, methods, norms	Specific capital, possessions, custom
3. Basic relationship	Exchange	Functional link	Trust
4. Format of relevant information	Monetary	Written, measurable, statistical	Oral
5. Form of commitment (persons)	Contract ('spot')	Plan	Promise
6. Hierarchy (of persons)	Purchasing power	Professional competence	Authority
7. Space	Indeterminate	Cartesian positioning	Polar positioning
8. Time	No temporality	From the present to the future	From the past to the present
9. Emergence of new objects	Negotiation	Innovation	Learning

*Source:* (Favereau and Thévenot, 1996)

## Hodgson and the revival of the 'old institutional economics'

Towards the end of the 1980s and especially in the 1990s, there was a revival of the influence of the original institutionalism, which had survived only as a marginal current of thought since the 1950s.<sup>6</sup> The reasons for this change included disappointment with the dominant body of economics and its neo-classical nucleus, especially with regard to the multiple problems of economic development, the structural changes in the capitalist economies and the post-socialist transformation, problems in which the institutional dimension is increasingly manifest.

The English economist Geoffrey Hodgson has played an active role in this revival, both through his editorial activity and through his own contributions to the history of evolutionary institutionalism. While positioning himself as a follower of Veblen, he emphasizes the historical influence of institutional economics, in the broad sense, on numerous theoreticians or intellectual currents since the end of the nineteenth century.

### Some significant publications

#### **Books edited by Geoffrey Hodgson**

*Economics and Biology*, Aldershot, Edward Elgar, 1993.

*The Economics of Institutions*, Aldershot, Edward Elgar, 1993.

*The Elgar Companion to Institutional and Evolutionary Economics*, Aldershot, Edward Elgar, 1994, 2 vols. (with W. Samuels et M. Tool).

*The Foundations of Evolutionary Economics 1890–1973*, Aldershot, Edward Elgar, 1998, 2 vols.

*A Modern Reader in Institutional and Evolutionary Economics: Key Concepts*, Cheltenham, Edward Elgar, 2002.

*Recent Developments in Institutional Economics*, Cheltenham, Edward Elgar, 2003.

#### **Books by Geoffrey Hodgson**

*Economics and Institutions. A Manifesto for a Modern Institutional Economics*, Cambridge, Polity Press, 1988.

*Economics and Evolution. Bringing Life Back into Economics*, Cambridge, Polity Press, 1993.

*Economics and Utopia. Why the Learning Economy is not the End of History*, London, Routledge, 1999.

*Evolution and Institutions. On Evolutionary Economics and the Evolution of Economics*, Cheltenham, Edward Elgar, 1999.

*How Economics Forgot History. The Problem of Historical Specificity in Social Science*, London, Routledge, 2001.

*The Evolution of Institutional Economics. Agency, Structure and Darwinism in American Institutionalism*, London, Routledge, 2004.

*Economics in the Shadows of Darwin and Marx: Essays on Institutional and Evolutionary Themes*, Cheltenham, Edward Elgar, 2006.



***Layered reality and emergence***

Adopting the same approach as Veblen, Hodgson states that Darwinism can be interpreted as a general methodology, whose scope goes far beyond just biology. The discredit cast on social Darwinism, and on what were claimed to be Darwinian references to certain racist or Nazi theories, had at one stage generated lasting but excessive suspicion regarding the borrowing of theses or metaphors from biology. The reality is that the three main principles put forward by Darwin – variation, inheritance and selection – as well as the ‘principle of evolutionary explanation’, the one used by Veblen, are applicable to a wide variety of natural as well as social phenomena. When accompanied by supplementary explanations appropriate to each scientific field, these Darwinian principles deserve to be recognized as a theoretical core having general validity. Consequently, while it does not give a complete explanation of socio-economic phenomena, ‘Darwinism provides a compelling ontology, it is a universal metatheory in which specific theories must be nested, and it is a rich but optional source of analogy’ (Hodgson, 2002: 278). The revival of evolutionary thinking in the social sciences, notably in the economic field, is capable of ‘bringing life back into economics’ in the twofold sense of a revitalization and reconnection with themes emanating from modern biology, without tipping over into reductionism.

According to Hodgson, two related themes, which were lacking in Veblen’s work, illustrate the strength of such a reconnection. The first is the concept of multiple levels of organization of any natural or social reality, which he analyses in terms of ‘multi-layered ontology’. For example, the physical, molecular, organic, mental, individual, human and finally social levels succeed each other and are interdependent. ‘Everything belongs to a level and each level has, within bounds, some autonomy and stability’ (2004: 32). What especially distinguish the levels of reality are the ‘emerging’ properties that surface during the move to a higher level. The concept of ‘emergence’, which implies qualitative novelty, is the second essential theme. ‘A property may be said to be emergent if its existence and nature depend upon entities at a lower level, but the property is neither reducible to, nor predictable from, properties of entities found at the lower level’ (2004: 32). The consequences of this for institutional economics, which had an evolutionary character from its origin, include in particular the possibility of justifying the use of the institution as an analytical unit and of demonstrating the reductionism involved in attempts to base macroeconomics directly on neo-classical ‘microeconomic foundations’ (2004: 408).

### ***The case for evolutionary thesmology***

Whereas Durkheim had defined sociology as ‘the science of institutions’, Hodgson proposes the extension of the domains of economics and sociology by creating a discipline specifically dedicated to the study of economic and social institutions, which he calls ‘thesmology’ (from the Greek *thesmos*, meaning ‘institution’). The purpose of this discipline would be to study the nature, the formation and the evolution of the rules, norms and structures that constitute the institutional material of social life (2001: 349). The study of political institutions, organizations, etc. would constitute sub-disciplines.

While he comes close to North in defining institutions as social rules, Hodgson nevertheless sets himself somewhat apart by retaining the broad concept emanating from the original institutionalism, which includes organizations in the category of institutions.

Institutions are durable systems of established and embedded social rules and conventions that structure social interactions. Language, money, law, systems of weights and measures, table manners, firms (and other organizations) are all institutions. In part, the durability of institutions stems from the fact that they can usefully create stable expectations of the behaviour of others. Generally, institutions enable ordered thought, expectation and action, by imposing form and consistency on human activities. They depend upon the thoughts and activities of individuals but are not reducible to them.

(2003: 163)

Organizations, for their part, are a special type of institution, which involve the following: the setting of criteria defining their boundaries and distinguishing members from non-members; principles of sovereignty making it clear who has control; chains of command determining responsibilities (2006: 8).

### ***Reconstitutive downward causation***

According to Hodgson, the new institutional economics, like the neo-classical approach, errs in considering individuals, their preferences and desires, as given.<sup>7</sup> The essential contribution of the old institutionalist tradition is, on the contrary, to regard interactions between individuals as being what leads to the formation of institutions, which in turn influence individual goals and preferences. ‘Institutions not only depend upon the activities of individuals but also constrain and mould them, this positive feedback gives institutions even stronger self-reinforcing and

self-perpetuating characteristics' (2003: 163). Individual behaviour is both constrained and facilitated by institutions, but these also give form to aspirations and modify them. Distinguishing between top-down and bottom-up causality chains, Hodgson describes such determination as '*reconstitutive downward causation*'.

The causal powers associated with social structures may not simply impede or constrain behaviour, but may also affect and alter fundamental properties, powers and propensities of individuals. When an upper hierarchical level affects components at a lower level in this manner, this is a special and stronger case of 'downward causation' that may be called *reconstitutive downward causation*. Those particular social structures that have the capacity for substantial, enduring and widespread reconstitutive downward causation upon individuals are termed *institutions*.

(2004: 188)

## 6 Unity and diversity of institutionalisms

In the study of any one of a wide range of economic questions, it is difficult to ignore the importance and influence of institutions. In fact, since the origins of modern economic thought, this thesis has been accepted in differing degrees by a significant number of currents and theories. However, the approaches that have explicitly taken into consideration the central role of institutions in the economy and have attempted to theorize this aspect, in other words the various schools that make up the family of institutional economics, flourished mainly at the turn of the last two centuries, either the end of the nineteenth and the beginning of the twentieth or the end of the twentieth and the beginning of the twenty-first. This family is remarkably diverse but nevertheless shares certain central concerns.

### Major common themes

The first major common theme is obviously the idea that, since the economy as a sphere of social activity is fundamentally ‘institutionalized’, economics as a science or a discipline has to take institutions into account and study them. It has to regard them as endogenous to their field, and not exogenous. And yet it was this latter point of view that in practice predominated during the twentieth century, under the influence of the neo-classical paradigm, whose ambition was to make economics a ‘hard’ science, quite distinct from the other social sciences, thanks in particular to axiomatization and formalization. Members of the institutionalist family thus also tend to be critical of, or to distance themselves from, the neo-classical tradition, notably its postulates of individual calculative rationality, and also its insistence on mathematical formalization.

A second common feature of this family, at least as dominant as the first, is the focus on the question of change in the study of the economy. This is because institutions represent an element of permanence in a world that is in perpetual transformation,<sup>1</sup> but institutions are also subject to change,

being born, evolving and disappearing. An institutional approach inevitably runs up against one of the classic questions for historians: the relationship between continuity and change. To be more precise, it is the diversity of temporalities of change in institutions and economic processes, or what might be called ‘change differential’ that becomes the focus of attention. As a consequence, interest in ‘processes’, or temporal sequences of cumulative change, predominates over the approach centred on ‘equilibrium’, which is the key concept in the neo-classical tradition.

Another frequent characteristic of currents of institutional economics is the theme of ‘emergence’. The unexpected, and sometimes not understood, consequences of individual or collective actions and the effects of composition or aggregation, whether they be regarded as beneficial (of the invisible-hand type), harmful (perverse effects) or ambivalent, occupy a major place once explicit attention is paid to the interactions between different levels of economic reality, for example, individuals, organizations, institutions and the economy or society as a whole.

### **Remarkable diversity**

In this book, we have identified significant differences, some of them major, between different authors or currents of thought which nevertheless carry similar labels or follow the same tradition. One only has to think of the divergences between Veblen and Commons within American institutionalism (Corei, 1995), the distance separating Williamson and North in the new institutional economics or the gap between regulation theory and the conventions school in French institutionalism. These differences combine in a complex manner with the distinctions among the currents or families making up the extended family of institutional economics. While partial – and *prima facie* improbable – rapprochements are to be seen, as, for example, between the Austrian tradition and the old (or new) institutional economics, what one mainly finds are doctrinal, methodological and theoretical divergences.

It is striking to note that the spread of doctrinal positions ranging from economic liberalism to interventionism or socialism is practically reproduced among the schools of thought representing institutional economics. The Austrian tradition is marked by strong fundamentalist liberalism, while at the other extreme one finds the socialist leanings of Polanyi, the active reformism of Commons in his search for reasonable capitalism and the authoritarian reformism of Schmoller. In general, the new institutional economics leans towards a temperate liberalism, while heterodox forms of institutionalism come closer to the interventionist or capitalism-reforming pole and tend to be critical of economic liberalism. There is therefore no

direct relationship between a doctrinal posture and membership of the institutionalist family.<sup>2</sup>

A similar variety is to be found in the methodological postures adopted for the analysis of institutional questions. The various tendencies of institutional economics have often contributed to a relativization of the superficial opposition between methodological individualism, which explains everything by individual actions, and holism or methodological collectivism, which gives precedence to collective structures as determining individual actions. Such a relativization is understandable, since the interaction between individual actions and institutions is a central concern of the institutionalist approach. It remains true, however, that, depending on the authors or the currents of thought, a leaning towards individualistic or holistic methodology still predominates, with a reconciliation between the two sometimes hoped for but more rarely achieved.

The gap revealed vis-à-vis neo-classical theory and the intensity of the criticism directed to it are extremely heterogeneous as between the various tendencies of institutional economics. While in its origins institutionalism was constituted by opposition first to the classical school and later to the neo-classical school, the Austrian tradition initially showed a strong affinity with the latter before increasingly distancing itself in the second half of the twentieth century. As for the new institutional economics, this represents a dissident neo-classical movement that can be interpreted as internal contestation, although sometimes coming close to a complete break.<sup>3</sup>

Finally, institutional economics modifies the conventional frontiers between the social sciences, inasmuch as institutions are also the subject of disciplines such as sociology, anthropology, political science and history. It is therefore perfectly logical that a multi-disciplinary tendency should be a common feature of the various currents of institutionalism in economics. Nevertheless, the preferences are in this case still heterogeneous, with some economists giving preference to the links with sociology, others to the links with history or law, and still others to those with the cognitive sciences. Nor is there a direct link between an institutional approach in economics and the type of multi-disciplinary approach that is practised or desired. An inclination towards historic questions or approaches is, however, frequently found among institutionalist economists.

### **Theoretical differences**

In addition to the differences that have just been referred to, it is also obviously necessary to stress the variety of substantive conceptualizations of institutions, their genesis, their role (or their function) and their relationship to the diversity of performances of economies at a given date or through time.

Table 6.1 Theories of institutional economics: a synoptic comparison

	<i>Schmoller</i>	<i>Veblen</i>	<i>Commons</i>	<i>Menger</i>	<i>Hayek</i>
Nature of institution	Set of habits and rules (customs, morals, law), having a purpose, forming a system	Shared habits of thought and action	Collective action controlling individual action	Social phenomena showing functionality vis-à-vis the whole	Rules and orders
Paradigmatic institution(s)	State	Private property; business firm; leisure class	Going concern, common law	Money	Money, language, morals, law (common law)
Analysis focused on informal and/or formal institutions	Informal and formal (custom and law)	Informal	Formal	Informal and formal (organic and pragmatic)	Informal (tradition)
Organizations (in relation to institutions)	'Organs' of institutions: gens, family, associations, corporations, firms, the State	Implicitly: organizations are institutions	Going concerns (organizations = institutions)	Implicitly: organizations are institutions	'Made' orders (as opposed to spontaneous orders, founded on different rules)
Theory of evolution	Historic stages	Methodological Darwinism; natural selection of institutions (+ historic stages)	Artificial selection of institutions (+ historic stages)	Innovation + imitation, invisible hand	Cultural evolution, selection of rules through selection of groups
History and institutional economics	Historical school	Direct recourse to history	Stylized history	<i>Methodensstreit</i> : exact method vs historical method	Long cultural history

Table 6.1 continued

	<i>Williamson</i>	<i>North</i>	<i>Aoki</i>	<i>Regulation</i>	<i>Hodgson</i>
Nature of institution	Modes of governance of transactions	Rules of the game; formal and informal constraints, enforcement	Self-sustaining system (equilibrium) of beliefs regarding the way the game is played	Codified fundamental relations; institutionalized compromises	Systems of embedded social rules structuring interactions
Paradigmatic institution(s)	Market, hierarchy	Property	Firms	Wage-labour nexus, State, money	Language
Analysis focused on informal and/or formal institutions	Formal	Informal and formal	Formal	Formal	Informal and formal
Organizations (in relation to institutions)	Hierarchies (organizations = forms of governance = institutions)	Players (within the rules that are the institutions), organizations differ from institutions	The organization is both institution and player	Distinction mentioned between organization and institution (reference to North)	Organizations are institutions
Theory of evolution	Choice based on minimization of transaction costs ( $\neq$ evolution)	Groups holding power introduce new rules; path-dependence, lock in	Theory of repeated games, multiple equilibria	Mounting tensions in a configuration; evolution punctuated by crises	Universal Darwinism (Veblenian)
History and institutional economics	Reference to Chandler concerning the large firm	Long history covering several centuries	Recourse to contemporary national, sectoral or local models	The Annales school; historical macroeconomics	History of ideas; problem of 'historical specificity'



We have been encountering these divergences throughout this book. Table 5.4 summarizes, in selective fashion, certain of these divergences, which are far from being of secondary importance.

There are many other cleavages in addition to those summarized here (Rutherford, 1994). The focus may be on institutions that are formed 'bottom-up', by spontaneous evolution, or on those that are established 'top-down', in a deliberate manner; the institutional analysis can be practised with a view to the reform or preservation of existing institutions; it can be motivated by criticism of socialism (Hayek) or of capitalism (Veblen); highly diverse approaches of human behaviour and psychology can be called on.

### **Limited subject, general theory**

One particular difficulty in the evaluation and comparison of various theories of institutional economics is that, while their ambitions are situated at the level of a general theory of institutions, they inevitably run up against certain limits related to the *type of problem* they are mainly trying to examine. These problems lie at levels that may tend to be macro- or micro- (or even meso-), they may be of a more historical or, conversely, more logical nature, they may concern formal or informal institutions, they may concentrate more on the domain of organizations or have much broader scope, and so on. Such differences between objects of study, which are entirely natural, are then combined with the doctrinal, methodological and theoretical distinctions already referred to. However, when an author or a school constructs a general theory of institutional economics, by extending and generalizing the conceptualization he or it has worked out in order to deal with relatively specific problems that are temporarily or spatially bounded, there is a risk of proposing a theory that is itself limited or biased as a result of the particular subject chosen for examination.

We have seen this type of limitation, for example, in the case of Commons' approach focusing on the American experience at the beginning of the twentieth century as the basis for his brand of institutional economics, in the case of Hayek's construction of a general theory of orders and rules in order to refute the constructivist pretensions of socialism (or of Keynesianism), when North examined the exceptional nature of the economic success of Western countries or in the theory of regulation, developed with the aim of understanding the history and succession of Fordism – the list is very long. It must be emphasized, however, that any theory in the social sciences is inevitably conditioned by its time, its context and its precise focus. Frequently, the contribution of an eminent thinker, or of a school of researchers, results precisely from the light which the study of the more or less bounded subject they have chosen to explore as a priority

casts on questions that are themselves much broader, even universal. This is why knowledge of the various theories, their history and their critical confrontation remains an essential precondition for launching any new creative research.

# Notes

## 2 Original institutionalism

- 1 Menger at the same time was distinguishing between institutions that are formed spontaneously (in *organic* fashion) and those that are set up deliberately (in *pragmatic* fashion) (see below).
- 2 Note that while Keynes was to use the term 'classical' to embrace both the classical school and the authors that we are accustomed to characterize as 'neo-classical', thus underlining, like Veblen, the continuity between these two traditions, both the Marxists and the Post-Keynesians would stress, on the contrary, the break between the classical school and the neo-classical current of thought.
- 3 One of the paradoxes in Veblen's work is that implicit normative postures are far from being rare in his own writings. It is true that he ignores any reformist concern, unlike Commons.
- 4 The notion of 'cumulative causation' was to be taken up and broadened by economists influenced by institutionalism, like Allyn Young, Kaldor and Myrdal, with the inclusion of the idea of positive feedback or increasing returns (Hodgson, 2004).
- 5 This is the definition most frequently given by Veblen in his writings. The concept of institutions is broadly applied to a wide diversity of phenomena such as private property, the leisure class, the monogamous family, 'pecuniary institutions', etc. The implication is that all these phenomena are based on habits of thought constituted in previous historic contexts.
- 6 Veblen was influenced by the theory of instincts and habits built up by William James and William McDougall.
- 7 A concept of evolution based on progressive stages was one of the characteristics of the German historical school, but is also to be found in the works of Smith and Marx. The historical evolutionism prevailing in the nineteenth century often tended to be finalistic or teleological.
- 8 When the beginning of the argument is reformulated in terms of informal and formal institutions, using North's terminology, it is seen that the latter are presented as the consequence of the formalization of the former: habits and conventions are thus codified into law. It has to be stressed that property constitutes the most important institution, according to the *The Theory of the Leisure Class*.
- 9 The theme of 'control' is not very Veblenian. It is to be found more in the work of Commons, through the concept of collective action.

- 10 Commons reproaches Veblen for borrowing the metaphor of natural selection in order to apply it to institutions; he opposes to it artificial selection, which in his opinion was Darwin's starting point.
- 11 For Marx, the legal sphere constitutes a superstructure on the economic base of society, determined by the latter. Commons, on the contrary, refers to the 'legal foundations of capitalism' (1924), thus in a way turning the Marxist metaphor on its head.
- 12 The theme of fundamental uncertainty in a monetary economy, reduced by the role of conventions, which is central in Keynes' work, seems to have affinity with Commons' conception. In his biography of Keynes, Skidelsky refers to Commons as 'an important, if unacknowledged, influence on Keynes' and quotes a letter from Keynes to Commons dated 1927 in which he writes that 'there seems to me to be no other economist with whose general way of thinking I feel myself in such general accord' (Skidelsky, 1995: 229). The interactions between institutionalists and Keynesians were to be significant in subsequent history.
- 13 In *The Great Transformation*, Polanyi lists a fourth, namely the principle of *householding*, consisting of production and direct storage for the needs of the closed group. But he does not retain this concept in his later construct, suggesting that it is related more to redistribution on a small scale.
- 14 He cites the following authors as having influenced his thesis: Marx, Maine, Tönnies, Weber and Malinowski (Polanyi, 1957).

### 3 The Austrian school and 'ordoliberalism'

- 1 Although Veblen cannot be called a constructivist, he can be counted among the critics of the tradition.
- 2 Hayek refers to the concept of 'emergence' in 'The theory of complex phenomena' (1967b: 26); this concept remains central, but implicit, in his theory of spontaneous order.
- 3 This provides one reason for his criticism of the concept of 'social justice' (1976).
- 4 This is one of the most disputed notions in Hayekian theory, including by proponents of the Austrian school, some of whom consider that it is contrary to methodological individualism.
- 5 Until around 1960 Hayek was a partisan of a relatively more 'constructivist' liberalism – and hence one that showed a certain affinity with German ordoliberalism – than in his work in the 1970s and 1980s, when his refusal of all interventionism intensified. This did not prevent him from proposing a liberal constitutional model in *Law, Legislation and Liberty* (1979).
- 6 A similar thesis is to be found in the work of Walras: 'instituting and maintaining free economic competition in a society is an undertaking of legislation, very complicated legislation, belonging to the State' (Walras, 1898: 476).
- 7 Hayek's liberalism is opposed to the use of the 'weasel-word' *social*, a source of error and confusion, both for the social market economy and for the 'mirage of social justice' (Hayek, 1976).

### 4 The new institutional economics

- 1 The idea that the 'old institutional economics' had a non-theoretical or even anti-theoretical orientation predominates with the new school. Coase notes that the expression 'new institutional economics' was intended to make this distinction: 'John R. Commons, Wesley Mitchell, and those associated with them were men

of great intellectual stature, but they were anti-theoretical, and without a theory to bind together their collection of facts, they had very little they were able to pass on' (Coase, 1998: 72).

- 2 Coase himself has written that the institutions that lie at the heart of economists' work are 'the firm and the market which together make up the institutional structure of the economic system' (Coase, 1988: 5).
- 3 In a later presentation, the three original structures are supplemented by (state) bureaus: Williamson refers to 'the institutions of governance (markets, hybrids, firms, bureaus)' (Williamson, 1998: 75), thus coming closer to heterodox institutional economics where one finds composite models of capitalistic co-ordination combining market, organization, networks and the State.
- 4 For Simon (1987), individuals do not seek to maximize objectives, which would imply exhaustive knowledge of the alternatives and a vast capacity for processing the corresponding information, as well as a large amount of available time to make the choices; in reality, they content themselves with a 'satisficing' (and not maximizing) level in the pursuit of their objectives and give up exploring alternatives when this level has been reached.
- 5 In his Nobel Prize lecture, he refers to an 'institutional/cognitive approach' (1994: 365).
- 6 In *Structure and Change in Economic History*, North had already written: 'Institutions are a set of rules, compliance procedures, and moral and ethical behavioral norms, designated to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals' (1981: 202). The abandonment of the thesis of institutional efficiency does not therefore imply calling into question maximizing behaviour, which tends to qualify North's recourse to bounded rationality.
- 7 The opposition presented here cannot fail to recall the conflict between predatory action and industrial action invoked by Veblen.
- 8 The concept of *path-dependence* (linked to increasing returns) is borrowed from Brian Arthur, that of *lock-in* from Paul David. Although devised to explain technological change, these concepts in North's view turn out to be particularly relevant for theorizing about institutional change, but with the difference that this latter concept is more complex because of the essential role played by political organizations.
- 9 Hayek's *The Fatal Conceit* (1988) contains an annex entitled 'Play, the school of rules', in which he remarks that a game is 'a clear instance of a process wherein obedience to common rules by elements pursuing different and even conflicting purposes results in overall order' (p. 154).
- 10 In game theory, Nash equilibrium is defined as a situation in which no player can improve his situation by acting on his own (without co-operating with the others) as the other players maintain their previous strategy. In certain respects, in the neo-classical movement this concept of equilibrium has supplanted that of general equilibrium derived from Walras, accompanied by Paretian optimum.
- 11 The author regards these latter approaches as functionalist, since they postulate that institutions are established deliberately by individuals looking to the future with the aim of fulfilling certain functions (in particular, reducing uncertainty, maximizing the well-being of the group or minimizing transaction costs). However, functionalist analysis is convincing only if it shows the mechanism linking the origin of an institution and its presumed effects.

## 5 Contemporary European currents of thought

- 1 It may be noted in passing that Marx could be considered to be a member of the institutionalist family, with the concept of institution taking the original form of 'relation' in his theory. The dominant institution of capitalism is for him capital (the 'capital-relation'), based on the interaction between the exchange relation and the wage-labour nexus (Chavance, 1996).
- 2 However, Théret (2001) has highlighted the affinities between Commons' institutional economics and regulation theory. See also Théret (2000) concerning the 'Commonsian' convergences between different contemporary institutionalist currents of thought in the social sciences, in particular, economics, sociology and political science.
- 3 It can be remarked in passing that Commons saw the State as 'an accumulated series of compromises between social classes, each seeking to secure for itself control over the coercive elements which exist implicitly in society with the institution of private property' (Commons, 1899–1900: 100).
- 4 Thus, 'in Fordism the wage-labour nexus played this role, because of the founding compromise [after the WW2] from which it originates. In the 1980s this hierarchy was replaced by the monetary and financial regime, which tends to dictate many developments in other areas' (Boyer and Saillard, 2002: 339). For Petit (2006), it is rather the forms of competition that have supplanted the wage-labour nexus in the new post-Fordist hierarchy co-extensive with contemporary neo-liberalism.
- 5 Regulationist writers have proposed the compound notion of 'holindividualism', bringing together the macro level of the institutions produced by individual actions and the micro level of individual actions conditioned by the existing institutions, distinguishing the different time frames of the genesis and change applying to the two levels (Boyer and Saillard, 2002).
- 6 Intellectual cycles are not infrequent in the history of economic thought, with the views and influence of a major author or school being subjected to eclipse and then rediscovery. Striking examples include the decline in the 1940s and the revival in the 1980s of the doctrine of economic liberalism, or the almost total neglect lasting more than 30 years of the theories of thinkers like Schumpeter or Hayek, before they became the subject of rediscovery and renewed interest. Conversely, Keynes' theories were influential between the 1940s and 1970s, but much of this influence has since been lost (perhaps pending a future comeback).
- 7 The author points out that while the evolutionary economics of Nelson and Winter (1982) ultimately acknowledged itself to be attached to the old institutional economics, both Hayek (1988) and North (1990) have also moved in this direction (Hodgson, 1998: 177)

## 6 Unity and diversity of institutionalisms

- 1 The historic originality of capitalism as a system or an institutional configuration is the continuity of the 'change' it generates. This thesis, developed by both Marx and Schumpeter, remains to this day the most profound diagnosis of this system.
- 2 It is worth noting, in passing, that even the neo-classical tradition showed itself to be compatible with a fairly wide range of doctrinal postures, for example when it achieved synthesis with certain Keynesian elements. It is

therefore an oversimplification to identify it as a theory with the liberal doctrine in economics.

- 3 This image of dissidence or breakaway needs to be qualified, however, as the neo-classical tradition is itself a large and highly diverse movement, whose boundaries are difficult to discern today. Its common base nevertheless remains rationality and individual preferences, the concepts of the market and competition, the paradigm of equilibrium, the notion of optimality, along with the implicit normative approach consisting of comparing imperfect empirical situations to efficient states of equilibrium.

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