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# Surveying the Methodological and Analytical Foundations of the New Institutional Economics: A Critical Comparison with Neoclassical and (Old) Institutional Economics

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**ABSTRACT:** *The purpose of this article is to review the methodological and analytical foundations of the New Institutional Economics by implying a critical comparison with the Neoclassical and (old) Institutional Economics. After a discussion of the fundamental definitions and concepts of the New Institutional Economics, I turn to the critical comparison with other schools of thought. It is shown that the New Institutional Economics does not break fundamentally from the neoclassical economics. To the contrary, it can be fairly argued that the New Institutional Economics is a research program which is developed within and around the dominant neoclassical paradigm. On the other hand, it is argued that the Old and New Institutional Economics constitute two distinct approaches to the analysis of institutions, stemming from different paradigmatic viewpoints that produce and nurture contrasting perspectives on how to theoretically tackle institutions.*

**Key words:** *institutions, organizations, Neoclassical Economics, Institutional Economics*

**JEL classification:** B40, B52

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## 1 INTRODUCTION

In recent years, the concept of "institutions" has become central in scientific and political discourse. This reflects a renewed awareness of the role of institutions in the functioning of (market and non–market) economies and in economic development more generally. In the light of today's economic turbulence and financial meltdown, the "big–bang" transition programs in the former socialist countries and the various structural adjustment programs in developing countries, politicians, economists and businessmen (from neoliberals to "new" leftists) very often converge to the fundamental idea that the "right" institutional framework constitutes a *sine qua non* condition to enhance economic growth and promote development. For instance, the International Monetary Fund (IMF) puts great emphasis on reforming corporate governance and financial institutions as a response to the 2008

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financial meltdown. Moreover, the poor economic performance of developing countries is explained in terms of the lack of a clearly defined and secure private property rights system. According to the mainstream idea, this is because in the absence of a guarantee that people can appropriate the fruits of their sacrifices, they would not take the initiative to invest, whatever the policies regarding macroeconomic balances, trade and industrial regulations may be. It is further believed, continuing this line of thinking, that effective incentives have to be privately appropriable and predominantly materialistic, and that therefore-paripassu- no form of property rights other than private property rights can provide adequate incentives for good performance.

This emphasis on institutions and (private) property rights raises the need for a scientific theorization of the issues involved, while also bringing to the fore some fundamental questions with regard to the origin and nature of different institutions, and to their desirability or otherwise, thus also raising the question of institutional change. Within economics, the new institutional economics has become well established. This trend in economics deals with the origin of (mainly capitalist) institutions within the mainstream tradition. Many of the catchphrases articulated within the new institutional economics, such as "institutions", "organizations", "transaction costs", "property rights" and "contracts", have become very common in orthodox economics discourse. This development is intellectually stimulating and interesting because it raises some fundamental issues with regard to the role and functioning of institutions.

In November 2009, Oliver Williamson was awarded the Swedish Central Bank 'Nobel' prize in economics.[2] This follows the award to Ronald Coase in 1991 and to Douglass North in 1993. Between them, Coase, Williamson and North, are the founders and most important representatives of the new institutional economics. This third Nobel prize is symbolic of the continuing vitality of the new institutionalist research program within, and around the borders of, the mainstream economics reflecting the idiosyncratic nature of the so called 'Nobel Prize in Economics'.[3]

## 2 NEW INSTITUTIONAL ECONOMICS: DEFINITIONS AND CONCEPTS

The new institutional economics as a body of theory emerged in the 1970's and 1980's, although its roots lie further back in time. It seeks to incorporate the theory of institutions into economics by internalizing their study in a manner compatible with the core tenets of the neoclassical economics. In this way, new institutionalism seeks to fill a gap in the mainstream (neoclassical) economic theorizing, where institutions, even when implicitly present, play virtually no role as exemplified by the examples of welfare economics and the Walrasian general equilibrium model. The common denominator of all institutionalists, old and new, is that institutions matter for economic performance, and that institutional

2 Alongside Elinor Ostrom, a political scientist.

3 On the other hand, in 1972, Gunnar Myrdal who in many ways reflects the spirit of the Old Institutional Economics was awarded the Nobel prize.

structures exert an important influence on economic behavior. According to the new institutionalists, the determinants of institutions can be analyzed with the aid of the neoclassical economic theory. In particular, their aim is to explain what institutions are, how they emerge, what purposes they serve, how they evolve and how—if at all—they should be reformed.

The new institutional economics is a research program which includes various theoretical trends, such as transaction cost economics (Ronald Coase, Oliver Williamson), property rights theory (Ronald Coase, Armen Alchian, Harold Demsetz), new institutional economic history (Douglass North, Robert Thomas), and the economic analysis of law (Ronald Coase, Richard Posner) to name but a few. Other theoretical approaches close to the new institutional economics, and sometimes defined as being within this research program, include public choice theory, constitutional economics, the theory of collective action and the principal–agent approach (Furubotn&Richter, 1998; Schotter, 1981; Richter, 2005; Menard & Shirley, 2008).

The term "new institutional economics" was coined by Williamson (1975), however, its origins can be traced back to Coase's classic 1937 article on the "Nature of the Firm". In his seminal analysis of the firm, through the introduction of the concept of (but not the term) transaction costs which a few decades later became the foundation of the new institutional economics, Coase attempted to answer the question "Why do firms exist?". Until then, within the neoclassical theory, the firm was merely treated as a production function which transforms inputs into outputs, thus representing what came to be known as the "black box" of the neoclassical theory—the firm.

All institutionalists see institutions as governing social interactions, or in North's terms, "by providing a structure to everyday life" (North, 1990). North (1990) went on to say that "institutions are the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction (…) in the jargon of the economist, institutions define and limit the set of choices of individuals. Institutional constraints include both what individuals are prohibited from doing and sometimes under what conditions some individuals are permitted to undertake certain activities", otherwise, "in the absence of constraints, we exist in a Hobbesian jungle and civilization is impossible" (North, 1990). For the new institutionalism, much more simply, institutions are formed to reduce uncertainty in human exchange.

Further, according to North (1990), there is a clear demarcation between the "institutional environment" and "institutional arrangements", and between "formal rules" and "informal constraints". For North (1990), the institutional environment or framework provides the "rules of the game" affecting and shaping behavior, while institutional arrangements include the "players of the game" or organizations—what Williamson calls "governance structures". "What must be clearly differentiated," North (1990) says, "are the rules from the players". "If the institutions are the rules of the game, organizations and their

entrepreneurs are the players. Organizations are made up of groups of individuals bound together by some common purpose to achieve certain objectives" (North, 1994). Thus, for North, the institutional framework represents the "constitutive rules" of the game where various organisations interact. Williamson (2000) appeals to this distinction and argues that the transaction costs economics is predominantly concerned with institutional arrangements, or governance structures.

There are, however, some major stumbling blocks in trying to sustain such a clear–cut distinction between the institutional environment and organizations. For one thing, the institutional environment of organizations includes other organizations, such as the state. Moreover, organizations themselves are made up of rules. Organizations and institutions are interlinked or vested within one another. They are not entirely separable species. Hodgson (2006) has argued that treating organizations simply as individual actors is problematic to the extent that organizations are defined as actors. If, however, it simply represents an abstraction from the internal relationships and mechanisms within organizations, he considers the treatment of organizations as individual players a legitimate analytical exercise. This abstraction, according to Hodgson, is legitimized by North's "primary interest in economic systems" and "on interactions at the national and other higher levels" (Hodgson, 2006).

Concerning the second demarcation, North (1994) exemplifies that "formal rules" are "(property) rules, laws, constitutions", and that "informal constraints" refer mainly to "norms of behavior, conventions, self–imposed codes of contact". This suggests that an alternative is to view the formal–informal distinction as similar to the distinction between explicit and tacit rules.

Hodgson (2006) has tried to clarify this distinction further through a comprehensive discussion of the different definitions and the problems involved in defining terms, such as rules (formal and informal), institutions, organizations conventions, habits, etc., and attempts to provide some tentative definitions himself. He defines institutions as "systems of established and embedded social rules that structure social interactions", and rules as "socially transmitted and customary normative injunctions or immanently normative dispositions, that in circumstance X do Y". Organizations, in turn, "are special institutions that involve a) criteria to establish their boundaries and distinguish their members from non–members, b) principles of sovereignty concerning who is in charge, and c) chains of command delineating responsibilities within an organization." Formal institutions are generally meant as institutions that are explicit, written or legal, whereas by informal institutions we generally mean non–formal, non–legal or inexplicit.

## 3 NEW INSTITUTIONAL VERSUS NEOCLASSICAL ECONOMICS

On the first page of his 1975 book *Markets and Hierarchies*, Williamson argues that the new institutional economics is based on the view "that received microtheory (…) operates at a too high level of abstraction", that "the study of 'transactions' (...) is really a core matter", and that "what they (i.e. new institutionalists are doing is complementary to, rather than a substitute for, conventional analysis".

One obvious idea delivered above is that the neoclassical theory is too abstract and does not encompass the reality and efficacy of transaction costs. The traditional microeconomic theory does not consider the set of activities that normally precede, accompany and follow market transactions and the associated transaction costs. Within the new institutional economics, the concept of transaction costs has become the center of Coase's and Williamson's analysis of the firm and is the basis of an approach to the theory of institutions and property rights linked mainly with the works of Alchian (1965), Demsetz (1967), Alchian and Demsetz (1973), and North (1981, 1990). Williamson (1985) argues that the neoclassical theory is similar to physics which studies a frictionless world, with friction being the analogue to transaction costs. By excluding transaction costs, the neoclassical theory also excludes institutions from its theoretical corpus. On the other hand, the inclusion of transaction costs in the theory makes it capable of dealing with institutions and reduces its level of "abstraction".[4]

However, the new institutional economics does not attempt to overturn or replace the neoclassical theory, but instead serves as "complementary to (…) the conventional analysis" (Williamson, 1975). The new institutional economics builds on, modifies and extends the neoclassical theory to permit it to come to grips and deal with institutions heretofore beyond its scope (North, 1995). In particular, the new institutional economics adds institutions as a critical constraint and analyses the role of transaction costs in the emergence and development of institutions and property rights. In this direction, the new institutionalists take a step away from the neoclassical economics by modifying the instrumental rationality assumption of the neoclassical theory through the adoption of Simon's (1961) concept of bounded rationality and Williamson's (1975, 1985) concept of opportunism. This is how Williamson (1975) delineates the principal differences between the neoclassical theory and his approach: "I expressly introduce the notion of opportunism and am interested in the ways that opportunistic behavior is influenced by economic organization and (…) I emphasize that it is not uncertainty or small numbers, individually and together, that occasion market failure but it is rather the *joining* of these factors with bounded rationality on the one hand and opportunism on the other that gives rise to exchange difficulties".

4 In his second book, Williamson (1985) concentrates on what he later on referred to as the "transaction cost economics", which, according to him, comprises "part of the new institutional economics".

Bounded rationality, for Simon (quoted in Williamson, 1985) denotes that "human behavior is *intendedly* rational but only *limitedly* so". Individuals are not omniscient and have real difficulties in processing information, in addition, they have restricted ability to handle data and formulate plans. Hence, Williamson (1975, 1985) assumes individuals to be only bounded rational, while North (1995) suggests that "the place to begin a theory of institutions (…) is with a modification of the instrumental rationality assumptions". Coase (1984), on the other hand, regards the assumption of "a (perfectly) rational utility maximizer" as both "unnecessary and misleading". Note that bounded rationality does not replace the assumption of instrumental rationality, but instead only relaxes the heroic assumption of perfect information. This means that being confronted with limited calculatory power, costly provision of information and a complex and uncertain world, the individual is not capable of acquiring perfect information, but nevertheless behaves in a rational manner, maximizing his/her utility.

Williamson (1985) defines opportunism as "self–interest seeking with a guile". What sets opportunism apart from the standard economic assumption of self–interest seeking behavior is the notion of guile, which includes individuals' inclination to "lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse". The existence of such behavior is important because, while bounded rationality prevents the writing of complete contracts, opportunism raises the transaction costs of negotiating and enforcing a contract even further.

Thus, Furubotn and Richter (1998) conclude that the new institutional economics is an amalgam of a critique of the standard neoclassical economics based on the absence of transactions costs, and an apparent move towards greater realism through a shift to a more empirically relevant model. This is achieved primarily by mellowing the concept of a fully rational "economic man", acting with full knowledge and certainty, into a concept of a "boundedly rational" individual acting upon limited knowledge.

However, the new institutional economics does not break fundamentally from the neoclassical economics. To the contrary, the new institutional economics is a research program which is developed within and around the dominant neoclassical paradigm. Although new institutionalists start by acknowledging the deficiency of the neoclassical economics in recognizing the effect of positive transaction costs and the role of institutions in economic development, they end up erecting a theory that tries to accommodate institutions within a neoclassical framework. While new institutionalists feel uncomfortable with the theory that seems to ignore institutions, they restrict themselves to a neoclassical attempt to deal theoretically with the fact that institutions matter. Institutional arrangements in this view are the result of rational responses to changes in the underlying economic conditions on the basis of the efficiency criterion. Consequently, the framework is built on the orthodox microeconomic theory, using the marginalist analysis, general equilibrium theory and the principles of methodological individualism, individual self–interested rationality and economic efficiency.

More specifically, according to North (1995), the new institutionalist approach "begins with the scarcity and hence competition postulate, it views economics as a theory of choice subject to constraints, it employs price theory as an essential part of the analysis of institutions, and it sees changes in relative prices as a major force inducing change in institutions".[5] These are the basic ingredients of the marginalist choice–theoretic approach and the static equilibrium theory of price (Coase, 1988).

Thus, the new institutional economics retains the neoclassical principle of methodological individualism, always couching its explanations in terms of the goals, plans and actions of individuals, and proposes an instrumental view of the emergence and change of institutions, i.e. all institutions have been consciously created in order to reduce the transaction costs of economic exchange and production. The result is that "the foundation stones of the NIE (New Institutional Economics) are the same as those of the neoclassical economics: methodological individualism and individual rational choice given as a set of constraints" (Richter, 2005). Similarly, "... (T)he exponents of modern institutional economics apply the analytical apparatus of the neoclassical theory (and newer techniques) to explain the workings and evolution of institutional arrangements, and thus expand the scope and predictive power of microeconomics (Furubotn & Richter, 1998).

Using the Lakatosian (1970) terminology of "hard core" and "protective belt" as the essential parts of research programs,[6] Fine and Milonakis (2009) argue that the new institutional economics retains the "hard core" of the neoclassical economics, i.e. maximizing behavior, market equilibrium, and stable preferences. On the other hand, there is a modification in the "protective belt" in the form of information and transaction costs, making property rights indispensable for the analysis of economic organizations.[7]

To sum up, the new institutional economics is not a development away from the neoclassical theory. Rather, it is best viewed as a demonstration of the use of the neoclassical conceptual

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5 From the central behavioral postulate of individualistic rational maximization, the new institutional economics constructs an (ahistorical) framework centered on the importance of relative prices. These are the main economic incentives to which individuals respond, and it is this rational response to prices that gives the approach its predictive potential. As North (1990, p. 84) puts it, "institutions change and fundamental changes in relative prices are the most important source of that change". It should be noted, however, that in addition to the role of relative prices, North (1981, 1990) recognizes the importance of ideology, culture and norms as crucial factors in the explanation of institutions. This suggests a form of eclecticism and allows North to avoid an overreliance on the rationality postulate of the neoclassical school. For a critique of North's theory see Milonakis and Fine (2007).

6 According to Lakatos (1970), a research program is an ensemble consisting of a hard core and a protective belt. The hard core is composed of the fundamental presuppositions of the program. It defines the program and its elements are treated as irrefutable by the program's practitioners. Hence, to participate in the program is to accept and be guided by the program's hard core.

7 Eggertsson (1990) also applies Lakatos' terminology to distinguish between a neoclassical–based "neo–institutional economics" based on optimising models, and the "new institutional economics" based on the idea of bounded rationality.

apparatus in explaining the emergence and evolution of institutions.[8] In this vein, the new institutional economics aims to fill a vacuum in the neoclassical theory without denouncing its theoretical basis, especially the model of (bounded) rational maximizing individuals, acting within given constraints (Furubotn & Richter, 1991). Thus, the analysis of institutions, as well as the impact of institutions on the behavior of economic actors are reduced to a cost–benefit calculation of (more or less) rationally acting individuals. Institutional arrangements are deliberately chosen by individuals on the basis of efficiency criteria. Hence, the emergence and evolution of institutions is viewed as the result of rational responses to changes in the underlying economic conditions. It can thus be suggested that the new institutional economics has grown mainly out of developments at the heart of the modern orthodox theory itself. As Simon (1991) remarks, "the new institutional economics is wholly compatible with and conservative of the neoclassical theory".

## 4 NEW VERSUS OLD INSTITUTIONAL ECONOMICS

The new institutional economics is contrasted with the "original" (or "old" or "American") institutional economics. The first explicit attempt to integrate institutions into economics can be found in Veblen's (1898, 1899, 1919, 1932) writings. He set out to turn economics into an evolutionary science and was highly critical of the static and mechanistic approach of the neoclassical economics.[9] Veblen is now widely acknowledged as the father of the "old institutional economics".[10] This tradition was influential in the USA in the 1920's and 30's headed by Veblen, Commons (1931, 1934), Mitchell (1913, 1914), and Ayres (1927, 1936, 1944).[11] Following this tradition, Galbraith (1952) uses the notion of power to explain the evolution of large firms in advanced economies. It was then seriously weakened and has slowly begun a recovery from the 1960's onwards when the Association for Evolutionary Economics was founded as a platform. The first attempt to revive the Old Institutional Economics was made by Grunchy (1987), however, Hodgson (1998, 1999a, 1999b, 2001, 2004) has been a prominent figure in the recent revival of the old institutional economics, mainly in the tradition of Veblen.

Old institutionalism rejects the mechanistic notion of individual agents as utility–maximizing in the pursuit of given preferences. To the contrary, it does not take the

8 For this reason, Fine and Milonakis (2009) describe the new institutional economics as being part of the process of the "economics imperialism", by extending the concepts of the neoclassical economics beyond its traditionally conceived "economic" spheres.

9 For an extensive overview of institutional economics see Hodgson (2004a).

10 The term "old" does not imply that the tradition is dead, dying or old–fashioned. It is used here simply to denote a demarcation line from the new institutional economics.

11 The rise to prominence of the institutional economics in the USA during the interwar period was the result of two weaknesses: first, of new microeconomics, which was professionally not strong enough to stand on its own feet, and second, of the failure of Marxism to get a hold on this part of the world as much as it had in various parts of Europe, thus leaving ground for a heterodox and critical school, such as institutionalism, to flourish (Milonakis & Fine, 2009; Hodgson, 1994; Fine & Milonakis, 2009).

individual as given in the orthodox version of the "economic man". For Veblen (1919), this is the basis for a fundamental critique of the mainstream economics which he describes as "the wants and desires, the end and the aim, the ways and the means, the amplitude and drift of the individual's conduct are functions of an institutional variable that is of a highly complex and wholly unstable character". The economy (and the market) is viewed by institutionalists as an open and dynamic system, affected by technological changes and embedded in a structural context comprising of social, cultural, political and power relationships. Old institutionalism emphasizes the importance of institutions in the economy and attempts to understand their role and their evolution. In doing so, it develops a theory of institutions and of human behavior by combining and developing methodological and analytical tools from psychology, sociology and anthropology (Hodgson, 2000).

New institutionalists do not see their work as a continuation of the endeavors of old institutionalists, but as a distinct effort to apply economic approaches to institutions.[12] As Coase (1984, p. 230) characteristically argues, "the phrase, 'the new institutional economics' was coined by Oliver Williamson. It was intended to differentiate the subject from the 'old institutional economics'. 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 that they were able to pass on". Williamson (1996), arguing in similar vein, points out that "where they differ is that older style institutional economics was content with description, whereas newer style institutional economics holds that institutions are susceptible to analysis".

Furubotn and Richter (1998) describe the division of the two approaches as follows: "At first glance, it might seem that exponents of the new institutional economics would show some interest in the work of the old institutionalists (…). Such concern with past work, however, is not found in the attitudes of neoinstitutionalists. While there may be some exceptions to the rule, most neoinstitutionalist scholars have been at pains to disassociate themselves from the central ideas put forward by the old institutionalists. What gave the original NIE advocates such confidence that they could disregard the older work on institutions was the belief that the standard neoclassical analysis could be readily *generalized or 'extended' to treat institutional problems*". In other words, as already mentioned, new institutionalists analyze institutions within the framework of the neoclassical economics, given the assumption of self–interest seeking individuals, attempting to maximize an objective function subject to constraints. In this light, institutions are incorporated as an additional constraint under the new institutionalist framework. As Langlois (1986) puts it, "the problem with many of the early institutionalists is that they wanted an economics with institutions but without

12 On the other hand, in the old institutional camp, one encounters voices calling for dialogue and reconciliation with the new institutional economics. For instance, Rutherford (1994) suggests that "(…) the OIE (Old Institutional Economics) and NIE (New Institutional Economics) could speak to each other to a much greater extent than is commonly recognized, and that there could be significant gains from such a conversation, particularly if the similarity of the problems being faced and the areas of complementarity that exist were to be the focus of the discourse".

theory; the problem with many neo–classicists is that they want economic theory without institutions; what the New Institutional Economics tries to do is provide an economics with both theory *and* institutions".

In short, the main differences between old and new institutionalists rest on the methodological and analytical grounds.[13] Old institutional economics underlines the role of habits, norms, culture and institutions in directing human behavior, without totally discarding rationality in individual behavior which is, however, constrained by the social and economic environment. On the other hand, the point of departure of new institutional economics is the individual itself. In the new institutional analysis, institutions are derived from an individual action, through interaction among individuals, hence remaining faithful to the neoclassical theoretical premises. As Hodgson (1993a) puts it, "the individual, along with his or her assumed behavioral characteristics, is taken as the elemental building block in the theory of the social or economic system (…) it is thus possible to distinguish the new institutionalism from the 'old' by means of this criterion". In this vein, new institutionalists use basically the deductive method as does the neoclassical economics. Their point of departure is always the individual together with some behavioral assumptions from which they go on to build a theory of institutions, property rights, the state, and so on.

Although both approaches recognize the role of institutions and agree that institutions matter, they nevertheless have distinct conceptualizations of institutions. As already mentioned (section 3), for new institutionalism, institutions are viewed as an additional constraint on human behavior, based on the standard neoclassical maximization subject to the constraints principle. According to Veblen's (1919) definition, however, institutions are "settled habits of thought common to the generality of men". Ayres (1962), on the other hand, underlines the role of culture in shaping institutions, while Commons (1990) proposes his definition of institutions as "collective action in control, liberation, and expansion of individual action". Thus, within the old institutional economics, institutions are viewed first and foremost on social and collective entities without, however, totally neglecting the role of individual action, as Commons underlined, while emphasizsing collective processes. On the other hand, the coordination of different individuals is explained not simply through reference to institutional structure, but also through the agent–level properties of shared habits (Spong, 2019).

The new institutionalist perspective on institutions has been developed on the basis of the transaction costs theory, where institutions are explained in terms of themaximizing behavior of individual agents, as outcomes of a conscious design. Institutional arrangements, in this view, are deliberately chosen by individuals on the grounds of their efficiency properties, and the basic source of institutional change is the substantial and persistent changes in relative prices. Hence, the emergence and change of institutions is viewed as the result of rational responses to changes in the underlying economic conditions.

13 On old institutionalism and its relation to new institutional economics see Langlois (1986), Rutherford (1994) and Hodgson (2004a).

In this way, the dynamics of the emergence and evolution of institutions are traced back to the cost–benefit calculations of rationally acting individuals. Generally speaking, new institutionalists adopt, explicitly or implicitly, a contractarian approach, explaining institutions as the intentional product of free and voluntary exchange. Contracts reflect the rules produced by social actors to facilitate the achievement of socially beneficial outcomes. The key point is that the resulting institutions are the product of voluntary agreement. Individuals create these institutions because they can benefit more than they would in their absence. The underlying motivation of institutional formation is individual utility and the concomitant pursuit of self–interest and, as such, the new institutionalist approach is heavily based on the principle of methodological individualism.

On the other hand, old institutional economics is based chiefly on the Veblenian evolutionary approach drawing upon the Darwinian analogy in biology.[14] Economics, Veblen (1898) argues, should focus on explaining evolution and change, rather than remaining stuck to a static equilibrium framework. Veblen, then, utilizes a Darwinian analogy in economics, arguing that institutional evolution is a process governed by natural selection. In his classic book, *The Theory of Leisure Class*, Veblen (1994) states in typical Darwinian fashion that "the life of man in society, just as the life of other species, is a struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions". In this vein, institutions are seen as the unintended result of individual actions, and institutional evolution proceeds according to a logic paralleling the logic of biological evolution. Hence, institutions are not explained by recourse to some economizing mechanism, such as the new institutionalist transaction cost minimization mechanism.[15] On the contrary, more contemporary ideas search the basis for the evolution of institutions in the evolution and competition of ideas in the public sphere (Markey–Towler, 2019).

Given their methodological and analytical differences, it becomes apparent that the old and new institutional economics constitute two distinct approaches to the analysis of

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14 Veblen was the first to use the biological metaphor in economics. In recent years, a growing number of economists stress the importance of the biological evolutionary metaphor in explaining social and economic phenomena. As a result, forms of evolutionary theory with reference to evolutionary arguments stemming from biology have acquired great prominence within economics. See Hirshleifer (1977), Nelson & Winter (1982), Witt (1993), Vanberg (1994), Vromen (1995), and Hodgson (1999a, 2004) for such attempts.

15 There are some instances of evolutionary arguments within new institutional economics, as in the work of Alchian (1950). Alchian attempts to incorporate the biological evolutionary perspective and the natural selection argument in the theory of firm. He proposes a view that the market economy, through its competitive process, is a system of selection that selects those agents whose mode of activities fit the environment. Specifically, those firms which fit well into the environment are more likely to earn positive profits, and earn, therefore survive. On the other hand, those firms which do not fit into the environment are more likely to make losses, and can therefore be removed from the economy. Consequently, the existing population of firms consists of those whose mode of activities fits with the environment. Similarly, although in less explicit fashion, Williamson (1985) seems to make reference to competitive pressures of selection and to evolutionary explanations of the organization of firms. However, evolutionary arguments within new institutional economics are quite rare and not very influential. On the other hand, Hodgson (2011) provides a concise history of evolutionary economics stressing the different approaches existing within the Old Institutional Economics.

institutions, stemming from different paradigmatic viewpoints that produce and nurture contrasting perspectives on how to theoretically tackle institutions.

## 5 IN PLACE OF CONCLUSIONS

Built on the premises of marginalism, methodological individualism and micro–rationality, the new institutional theory provides an analytical framework that fails to incorporate in a comprehensive manner any reference to social structures and relations, power and conflict. As such, this theoretical framework does not sufficiently take into account the dynamic historical evolution, removing in this way history from economic theorizing. New institutional economics tries to establish universal laws based on human nature, irrespective of place and time, and, as a result, portrays individuals as asocial self–interested creatures, as embodied in the 'homo economicus' postulate. Thus, the emergence and evolution of institutions, as well as the impact of institutions on the behavior of economic actors, is causally associated with the cost–benefit calculations of (more or less) rationally acting individuals. In this vein, any attempt to explain institutional formations suffers from the substantial problems that the new institutional economics has inherited from the asocial and static equilibrium approach of the neoclassical economics.

Both in society in general and in the scientific community, the advent of the New Institutional Economics and its focus on institutions have lead some scholars to argue for a possible reconciliation, for a potential convergence between the two paradigms, i.e. between the New and Old Institutional Economics. For instance, Pessali and Fernandez (1999) argue that Old Institutional Economics can and should build bridges with Williamson's Transaction Cost Economics research program. In similar vein, Hodgson (2004) views the development of North's thought from the neoclassical economic history of *The Rise of the Western World* to his current institutionalism as a steady–paced move from the preconception of orthodoxy. Thus, the suggestion is that the seemingly fundamental methodological and analytical differences between the New and Old Institutional Economics are not so fundamental after all. Rather the opposite. Since the New Institutional Economics, mainly by North, has already absorbed into its analysis many elements of the Old Institutional Economics, i.e. the notions of culture, habits, power and ideology, a "building bridges" perspective between the two paradigms is proposed. Although this idea seems viable, on the other hand, it may lead to a theoretical apparatus that could become somewhat of a paradise for the eclectic (Meramveliotakis, 2020).[16]

In order to avoid the potential problem of eclecticism, an alternative theoretical framework for the analysis of the origins and development of institutions in general, and of property rights in particular, shouldreturn to the basic questions, problems and conceptions of the

16 This was, for instance, Veblen's ultimate appraisal of the economics of Marshall, who tended to give great concessions as to the limits of the neoclassical economics, yet keeping it as a basic framework anyway.

classical political economy (Meramveliotakis, 2018).[17] In such a framework, the social should be taken as the point of departure in the form of social relations, structures, interests, power and conflict. One has to move beyond the one–sided solution to the problem of how social structures and actions are related, as offered by methodological individualism, towards a more dialectical mode of analysis of this relationship. Such a conception does not exclude human actors as subjects of history, but neither are they entirely free agents, able to shape their destiny irrespective of the existing structural conditions. In this vein, concerning the totality of society, individuals enter into social relationships that are partly independent of, and partly depended on, their will. Human history is guided by dialectical relationships of social structures and individual action. Reducing this complex dialectical relationship into a one–way process, as new institutionalists have done, will result in a reductionist conception according to which all social change is considered the result of individual action.

All institutions involve social structural properties and as such, an alternative theoretical framework must fully integrate the totality of social relations, including collectivities, such as classes. Thus, we have to move away from the new institutionalist conceptions of social relations formed exclusively at the level of individual exchange, and where classes are considered as mere aggregations of individuals, towards a deeper analysis of the structural elements of the societal whole as an essential starting point for a coherent theory of institutions. In this vein, the issues of power and power relations must become *sine qua non* conditions for a comprehensive analysis of institutional arrangements.

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17 In classical political economy, the notion of equilibrium is viewed as an endless evolutionary process in terms of production and reproduction of the capitalist system. In this context, the capitalist institutional framework is analyzed through an evolutionary–dynamic perspective. Despite its realism, the classical conception of equilibrium was gradually replaced by the neoclassical scarcity approach, according to which equilibrium is an end–static state, rather than a description of the way in which the institutional framework of capitalism organizes and reproduces itself.

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