

Beyond the rhetoric of constraints: the constitutive role of institutions on economic development

Marcelo Mallet Siqueira Campos *

Octavio A. C. Conceição **

Abstract

A substantial part of economic literature about institutions defines institutions as “constraints” that shape human interaction. This view is largely based on North (1990). Institutions are also described as rules and norms that “enable” human interaction to take place. In this view, there are restrictions to individual behaviour that enables society to do more. The “constitutive” role was suggested by Hodgson (1988; 2004), Chang and Evans (2005), among others. This view was inspired by contributions of John R. Commons (1934) who describes collective action as restraint, liberation, and expansion of individual action. This paper aims to examine the rhetoric of constraints and contrast it with constitutive role of institutions. This is a broader definition that allows the understanding about deliberative institutional change to promote economic growth and economic development. The concept of reconstitutive downward effect will be applied to understand institutional change. The process of institutional change is a reinforcing system: Institutions shaping worldviews and worldviews shaping institutions. The deliberate process of institutional change on economic development will be analysed. Some examples from Brazil in the 20th Century will be analysed: creation of organizations (Public Owned Enterprises, Universities, Research Institutes); changes in law; changes in the “ideology” (attitude towards economic development).

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* Researcher at Fundação de Economia e Estatística do Rio Grande do Sul (FEE) and Professor at Instituto Federal de Educação, Ciência e Tecnologia do Rio Grande do Sul (IFRS).

** Associate Professor of the Department of Economics and International Relations at Universidade Federal do Rio Grande do Sul (NERI/UFRGS) and of the PPGE/UFRGS. Researcher of CNPQ.

1. Introduction

After a long period of hibernation, economists have turned back to assess the importance of institutions in the last decades. Institutional analysis can be applied to many fields, as economic history, labour economics, public choice, industrial organizations, etc. It includes economic development. Institutions are complex and subject to many theoretical interpretations. For the purposes of this paper, it will be considered the definition made by Geoffrey Hodgson, who saw institutions as “durable systems of established and embedded social rules that structure social interaction” (HODGSON, 2005, p. 86).

There are three ways to describe the role of institutions and its relation to economic development. Institutions could be seen as:

- I. Constraints, a vision mainly associated with New Institutional Economics;
- II. Enabling, when they promote exchange, as the description contained in North (1990, p. 92);
- III. Constitutive, a function neglected by many, but emphasized by Hodgson.

There are different theoretical traditions which implies in different discourses about the importance of institutions. Not only the theory is important, the discourse also is. The view of institutions as constraints is very influent, affecting economic policy around the world.

A substantial part of economic literature about institutions defines institutions as “constraints” that shape human interaction. This view is largely based on Douglass North (1990). Institutions are also described as rules and norms that “enable” human interaction to take place. In this view, there are restrictions to individual behaviour that enables society to do more. The “constitutive” role was suggested by Hodgson (1988; 2004), Ha-Joon Chang and Peter Evans (2005), among others. This view was inspired by contributions of John R. Commons (1934) who describes collective action as restraint, liberation, and expansion of individual action. This paper aims to examine the rhetoric of constraints and contrast it with constitutive role of institutions. This is a broader definition that allows the understanding about deliberative institutional change to promote economic growth and economic development.

These rhetorical are result of different theoretical traditions and distinct schools of thought. In recent years, there was a revival of institutionalist analysis. But much of it was leaded by New Institutional Economics (NIE) which claims no relation to Original

Institutional Economics (OIE). Both were North American schools of thought. The foundations of old one were laid by Thorstein Veblen, John R. Commons, etc. in the beginning of 20th Century. Nowadays there is a reclaim of this tradition by the British economist Geoffrey Hodgson. In Europe the contributions of the pioneers of institutionalism are combined with contributions of other heterodox economists of many approaches, like Marx, Schumpeter, Polanyi, etc.

Economic development is an evolutionary process, the theoretical basis have to be related to a Veblenian ontology. Hodgson developed the concept of *reconstitutive downward effect* to understand the interaction among individuals and institutions. This concept will be presented and the possibility of a deliberated process of institutional change will be explored.

The aim of this paper is to go beyond the rhetoric of institutions as constraints. To illustrate the constitutive role of institutions it will be analysed the institutional change in 20th Century Brazil's. There was a deliberate process, leaded by the State. It involved not only formal institutions but creation of a developmentalist attitude. The exam of this institutional change will focuses on creation of organizations (Public Owned Enterprises, Universities, Research Institutes); changes in law; and changes in the "ideology" (attitude towards economic development).

2. Institutions as constraints

The view of institutions as constraints is usually associated with New Institutional Economics. There are formal and informal constraints that are "are imbedded in language, physical artifacts, and beliefs that together define the patterns of human interaction" (NORTH, 2005, p. 1). When mainstream considers the role of institutions it is described as restriction to transactions. Following the logic of this approach, economic development occurs with an increase in transactions.

Notwithstanding, is possible to identify the origin of that rhetoric in the old institutionalism, in the works of Clarence Ayres. Despite the positive aspect of institutions have been present on Original Institutional Economics, in Commons works, when Ayres became the leader of North American Institutionalism imposes a negative view:

"Ayres saw institutions as entirely negative. Unlike Veblen, Dewey, Commons and many others, Ayres did not understand that institutions can

enable activity as well as constraining it, and that institutions provide indispensable stuff and structure to social life” (HODGSON, 2004, p. 353).

In his view, there is a dichotomy between technology and institutions. Technology is seen as the main driver of economic progress. Ayres saw institutions as constraints to technological progress. In its view (AYRES, 1960, p. 52) were the technological advancement and the institutional structure of society which determines economic development.

Economic development will depend on how the “dynamism of technology” and the “inhibitory force of institutionalized traditions” interact (AYRES, 1960, p. 50). The institutional structure of society will also defines how the results of progress will be shared among the members of the society.

This vision, however, lack the important role that institutions have in social life:

“Ayres did not acknowledge that some institutions are necessary for social life. In reality, some degree of rule-bound inflexibility is required to create stable expectations, coordinate activities, enable communication and foster social cohesion. On the other hand, some degree of openness and flexibility is necessary to accommodate innovation and change.” (HODGSON, 2004, p. 357)

Ayres became leader of American institutionalism after Commons death in 1945, when institutionalism lost its importance and prominence in economic thought. With emergence of New Institutional Economics in the last decades of the 20th Century, the rhetoric of institutions as constraints arose, reassessing the negative role of institutions.

Nevertheless some authors related to New Institutional Economics saw institutions generating efficiency. If institutions reduce transaction costs, they will increase economic efficiency.

Douglass North research on economic history showed the possibility of an institutional innovation generates positive effects. He analyses the role an institutional change like the reduction of piracy and privateering as a factor in the growth of efficiency (NORTH, 1968). North adds transaction cost economics to the study of economic history.

Institutions, Institutional Change and Economic Performance (NORTH, 1990) is one of North’s greatest theoretical contributions. Institutions are described by North as the rules of the game. He recognizes that in all societies people impose constraints upon themselves and that those constraints could improve economic performance: “Under conditions of limited information and limited computational ability, constraints

reduce the costs of human interaction as compared to a world of no institutions” (NORTH, 1990, p. 36).

I have used the term efficient in this study to indicate a condition where the existing set of constraints will produce economic growth. Specifically, institutions that enable the parties in the exchange to capture more of the gains from trade will grow relative to those that fail to realize this potential. (NORTH, 1990, p. 92)

North describes a set of constraints that produce economic growth as efficient. Institutions that enable the parties to exchange and capture gains from trade are viewed in this sense. This is the enabling aspect of institutions. This kind of institutions tends to grow over the others (NORTH, 1990, p. 92). The constraints and the structure can lead to increase in economic efficiency or to stagnation (NORTH, 2005, pp. 1-2). Institutions are evaluated through a functionalist¹ point of view.

I shall explore below the determinants of the terms of exchange; but first it is essential to specify the individual behavioral characteristics that lead to the constraints that make up institutions. We do so by invoking the individualistic maximizing postulate of economic theory. That postulate assumes that individuals in the absence of any constraints maximize at any and all margins; it is, then, constraints that make possible human organization by limiting certain types of behavior. In the absence of constraints we exist in a Hobbesian jungle and civilization is impossible.

The constraints on behavior range from taboos to rules to exhortation. While some of the constraints are common to all societies (there are certain minimal behavior patterns necessary for any cooperative activity), others are specific to the interests of principals in different contextual settings. (...) While it is useful to separate constitutional rules, operating rules, and normative behavioral codes, in practice they are frequently overlapping. (NORTH, 1981, pp. 202-203)

Institutions structure human interaction. According to North (2005), humans create the institutional structure to reduce uncertainty in a complex world. However, the uncertainty can be reduced, not eliminated. The constraints imposed in this context have uncertain outcomes.

North (1990) also notes that institutions can be created or can simply evolve over time. Departing from it, we must highlight that the interaction between individuals and institutions and the institutional change are evolutionary processes.

¹ The belief that institutions exist only because of economic efficiency, shared by many adepts of New Institutional Economics, is subject of critic: “By employing the rhetoric of ‘constraints’, they still maintain the myth that the unconstrained market is the natural order, while institutions are man-made substitutes that should be (and will be) deployed only when that natural order breaks down” (CHANG & EVANS, 2005, p. 102)

3. The constitutive role of institutions

Geoffrey Hodgson states that “the potentially positive and enabling aspect of institutions has to be placed alongside their function as constraints” (HODGSON, 2005, p. 85). He opposes the view of Ayres and many new institutionalists: “On the other hand, institutions are not as rigid as Ayres suggested. Just as technology is itself conjoined with tradition, institutions can be dynamic and enabling” (HODGSON, 2004, p. 359). Technology is not always dynamic, as Ayres suppose, lock-in can occur. Furthermore stability in technological patterns is an important factor for innovation.

As examples of institutions that can be enabling is possible to mention: the traffic conventions that decide in which side of the road people should drive (what enable people to drive faster); the language (which improves communication and understanding); the establishment of metric system or technical standards, etc. (HODGSON, 2006a). Institutions can be positive even in relation with technology (contrary to Ayres’s dichotomy):

“Arguably, some institutions actually help to encourage technological advances. Modern patent laws are a likely example. Patents provide incentives for innovation by preventing others from copying the invention without payment to the inventor. The institutional restrictions of the patent system can thus enable technological innovation.” (HODGSON, 2004, p. 359)

Describing institutions as enabling devices does not deny that institutions impose constraints. (CHANG & EVANS, 2005). Even Douglass North recognizes this role of institutions, as mentioned above. However, the positive aspect goes beyond the enable view. There is a critical vision: the constitutive role.

The “constitutive” role was suggested by Hodgson (1988; 2004), Chang and Evans (2005), among others. This view was inspired by contributions of John R. Commons who describes collective action as restraint, liberation, and expansion of individual action:

“Collective Action is more than *control* of individual action – it is, by the very act of control, as indicated by the auxiliary verbs, a *liberation* of individual action from coercion duress, discrimination, or unfair competition, by means of restraints placed on other individuals.

And Collective Action is more than restraint and liberation of individual action – it is *expansion* of the will of the individual far beyond what he can do by his own puny acts” (COMMONS, 1959, p. 73)

That is, when the collective action imposes limits to individual action it allows other individuals to expand their action.

“Since liberation and expansion for some persons consist in restraint, for their benefit, of other persons, and while the short definition of an institution is

collective action in control of individual action, the derived definition is: collective action in restraint, liberation, and expansion of individual action” (COMMONS, 1959, p. 73)

To understand the process of institutional change is necessary to stress that ideas play an important role. Institutions have a subjective element, shaping moral values and worldviews. The interaction between individuals and institutions and between ideas and actions are structured by the framework developed by Hodgson.

4. Reconstitutive downward effect

The principle of *reconstitutive downward effect* is central in the understanding of the process of economic change. This concept was coined by Geoffrey Hodgson. It is originated in Veblen’s cumulative causation. Veblen also inspired the concept of “circular cumulative causation” created by Gunnar Myrdal which is applied to the analysis of economic development.

The contributions from Veblen are recalled by Hodgson (2004, p. 179) that states four propositions that are implicit in the writing of Veblen:

- I. The dependence of social structures upon individuals
- II. The rejection of methodological individualism
- III. The dependence of individuals upon social structures
- IV. The rejection of methodological collectivism

“They mean that individuals and social structure are *mutually constitutive*” (HODGSON, 2004, p. 179). Hodgson (2005, pp. 91-94) departs from Veblen to develop the concept of *reconstitutive downward effect*. This is a way to solve an old dilemma in social sciences, if individual behaviour is determined by collective or vice-versa. The term “downward causation” was borrowed from psychology. It implies that individuals and populations, at lower levels of the system, respond to causal powers associated with higher levels. Institutional changes and constraints can cause changes in habits of thought and behaviour. As institutions are subject to habits of individuals, the effects shift to the higher level. Therefore, institutions are simultaneously objective structures and subjective springs of human agency. “Actor and structures, although distinct, are connected in a circle of mutual interaction and interdependence” (HODGSON, 2005, p. 92).

Originally, Hodgson adopted the concept of *reconstitutive downward causation* to describe the relation between individuals and institutions. Hodgson (2011) proposed the term *reconstitutive downward effect* because the earlier definition was misleading.

There is a reinforcing system: Institutions shaping worldviews and worldviews shaping institutions. Economic development could be seen as a result of interaction between individuals and institutions.

The definition of habits constitutes the institutional framework. At this point there is convergence among the old and new institutionalisms: with North recognizing the importance of shared mental models (that determines the economic structure and institutions), a positive dialog with Hodgson (2006a, pp. 159-161) occurs. Endogenous preferences and individual rationality created by culture and institutions reinforce the existence of a Veblenian evolutionary ontology (CONCEIÇÃO, 2012, p. 125).

In the sequence we will discuss the elements that constitute the referred ontology. It is important emphasize that this analytical instrument must be inserted in an evolutionary perspective derived from the thought of Veblen.

5. The notion of evolution, Darwinism and self-organization

The debate on economic growth and institutions emphasizes that this process cannot be learned without an evolutionary environment. The comprehension and systematization of the referred process without this referred approach is extremely poor, fragile, empty from the point of view institutionalist, and methodological. Institutions, economic growth and evolutionism are inseparable. That is the reason why is necessary to discuss the meaning of the idea of evolution.

Institutionalists linked to Veblen's tradition as Geoffrey Hodgson gave a systematic treatment to the concept of evolution bringing it near to institutional environment. Hodgson & Knudsen (2006, p. 1) answer 'what is evolution?'

“(...) [a]t least etymological or historical grounds, there is little point in trying to give the word a narrow or well-defined meaning. Etymologically, like the word ‘development’, ‘evolution’ derives from the Latin verb *volvere*. (...) The word ‘evolution’ therefore derives from the Latin word associated with a specifically directional and predestined activity; the scroll is unrolled to reveal that which is already written within.”

Spencer did much more than Darwin to popularize the term evolution. In the first edition of *The origin of Species*, Darwin did not use this expression and just one time wrote *evolved*. Nowadays evolution is used in many senses so that it is impossible

to elect a unique and exclusive Darwinian definition. Instead of an unfruitful discussion about the meaning of the word evolution, Hodgson & Knudsen prefer to analyse the concerned phenomena:

“We refer to a broad class of systems and populations of entities, including all feasible manifestations of development and change. We then show, under some minimal conditions, that ongoing change in such systems is inevitably Darwinian in the sense that it must involve Darwin’s central principles of variation, inheritance and selection.” (HODGSON & KNUDSEN, 2006, p. 2).

Over the last 300 years the evolutionary thought had advanced too much, originating new insights and outcomes highly complexes. However, the main exponents of this thinking, such as Bernard Mandeville, David Hume, Adam Smith and Carl Menger pointed out that social order and institutions resulting from the individual interactions. Following Hodgson & Knudsen (2006, pp. 3-4) it is important emphasize that:

“Rather than simple, mechanical systems, the objects of our discussion are complex systems, at least in the sense that they involve a variety of entities that interact with one another. Such complex systems produce some outcomes that are not willed by any individual entity and have properties that do not correspond to any individual entity taken alone.”

Such complex systems include a population of entities with specific types, whose members are similar in general, but inside each group there is variation due to genesis or circumstances. How all the entities are mortal and degradable they need to consume material and energy to survive or to minimize degradation. But how they can not to access all the environmental resources all the time they face to an omnipresent problem of local and immediate scarcity. These entities are permanently involved in a struggle for the existence which refers Darwin (1859). This term constitutes the basis of the Darwinian principle of heritage that refers to the wide class of mechanisms, including replication and descends, by which information related to the adaptation are retained, preserved, passed on or copied through time. Hodgson & Knudsen (2006, p. 4) state that:

“Examples of populations in such systems are plentiful both in nature and in human society. They include every biological species, from amoebas to humans. They would include self-replicating automata, of the type discussed by von Neumann (1966). In addition, and importantly for the social scientist, they include human institutions, as long as institutions may be regarded as cohesive entities having some capacity for the retention and replication of problem solutions. Such institutions would include business firms.”

This wide scheme of the evolutionary system is crucial to understand that evolution must include three Darwinian principles: variation, inheritance and selection². Individually, firstly, it is necessary to emphasize that there must be some explanation of how variety occurs and how it is replenished in a population. In biological systems this sort of answer involves genetic recombination and also rare mutations. However, in the case of the evolution of social institutions there are no analogous mechanisms, remaining the existence and replenishment of variety a vital question in the evolutionary research (Metcalf, 1998; Nelson, 1991; Saviotti, 1996 *apud* Hodgson & Knudsen, 2006, p. 5).

Second, there must be an explanation about the form how useful information concerning solutions to particular adaptive problems is retained and passed on. In biology, these mechanisms often involve genes and DNA. In social evolution, is included the replication of habits, customs, rules and routines. To Hodgson and Knudsen (2006, p. 5): “(t)here must be some mechanism that ensures that some such solutions (embodied in habits, routines or whatever) endure and replicate; otherwise, the continuing retention of useful knowledge would not be possible”.

Third, there must be an explanation about the fact that the entities have different longevity and fecundity, so that in a given context some of them are more adapted than another one, some survive more than others, and some are more effective than others concerning the generation of descendants. From this emanates the selection principle which involves a set of previous entities each one interacting with its own environment, and being transformed into another set, where all the members of these new set are sufficiently similar to the members of the previous environment and where the resulting frequencies of the entities depends on their properties in the environment context. Through selection a set of entities, a population, gradually adapt itself as an answer to the criteria's defined by the environment factor.

It is necessary to emphasize that the outcomes of the selection process are neither moral, nor just, and there are no commitment of being necessarily optimal or the best concerning their precursors. Insofar efficiency is relative to the given environment, and it is tolerable rather than optimal. That the reason why Hodgson & Knudsen (2006, p. 6) state what follows:

² To Hodgson and Knudsen, (2006, p. 5): “These are the broad Darwinian theoretical requirements. They do not themselves provide all the necessary details, but nevertheless they must be honored. Otherwise the explanation of the evolution will be inadequate.”

“Darwinism does not assume that selection brings about globally efficient or (near) optimal outcomes, and in certain instances selection can even lead to systematic errors (Hodgson, 1993; Hull, 2001). There is no reason to believe that the special requirements needed to asymptote global efficiency are commonly present in nature or society.”

Another important question is about self-organization. This process shows that it is possible to obtain self-organized and complex outcomes without the presence of a designer or a planner to conduce the movement toward a previous way. This asserts contrasts with a common view inside the social science which “(...) all social phenomena are the result of conscious design, many complex and efficacious human institutions such as language and common law are not the outcome of an overall plan” (idem, p. 6).

Self-organization is so important in nature that it is easy to observe that complex and intricate patterns and outcomes can be obtained through interactions and accumulated steps. In the words of Hodgson & Knudsen (2006, p. 6):

“Just as self-organization reminds us that not every human creation is the result of a plan, it also removes the hand of God from explanations of many wonders of nature. But is self-organization sufficient to explain the origin of species and all complex biological phenomena? The definite answer is no. Darwin’s principle of selection is also required. Unfortunately, some writers, marveling at the outcomes of self-organization, have proposed that it is sufficient as an evolutionary explanation of all complex phenomena.”

Despite the great importance of self-organization not all human creation is a result of a plan, so that self-organization is insufficient to explain the origin of the species and the complex biological phenomenon³. It is a necessary but not a sufficient condition. It is also necessary to include the Darwinian principle of selection. Both of them constitute the nature of Darwinian process. The absence of one or other will obstruct this process.

Some writers wondered with the outcomes of self-organization have proposed that it is sufficient as an evolutionary explanation of all complex phenomenon. Such in biology as in other social sciences these writers did not have emphasized the importance of evolutionary selection and the Darwinian intellectual revolution. In biology neither the individuals nor the species and the ecosystems are completely self-transformers.

³ Following Hodgson & Knudsen (op. cit, p. 6): “In both biology and the social sciences, they have thus downplayed the importance of evolutionary selection and the importance of the Darwinian intellectual revolution. Although he embraced much of Darwinism, Hayek (1973, pp. 22–23) belittled its significance with the statement: ‘Those eighteenth-century moral philosophers and the historical schools of law and language might well be described . . . as Darwinians before Darwin. . . . A nineteenth-century social theorist who needed Darwin to teach him the idea of evolution was not worth his salt’. This underestimates the importance of the specific contribution of Darwin, especially in terms of the principle of selection, and encourages others to place more emphasis on the emergence of undesigned social order than on the sifting and selection of rival social institutions.”

Evolution happens inside the opened systems including endogenous and exogenous changes. Commonly the evolution occurs through internal changes and interaction with the environment. Quoting Darwin (1859 *apud* Hodgson & Knudsen, 2006, p. 8), the isolation mechanisms have important effects on the evolutionary trajectory of the ecosystems, because isolation asserts new variation to the time to evolve slowly, despite the fact that it reduces the variation level that is been produced. The breakdown of the isolation mechanisms increases the variation level presented by the population taking them sometimes to surpass the system rigidity.

In biology, many of the changes in a specific area are due to the introduction of existing species from other region which interacts with their neighbours affecting the evolution course. Exogenous chocks, as the meteors impact and climatic changes, are source of influence on evolutionary process taking to the expansion of some species and the extinction of others. In the same way, sometimes changes stimulated exogenously in the social evolution have a great importance because cultural mechanisms of imitation and conformism tend to reduce internal varieties and can take to institutional ossification. Some examples in this sense quoted by Hodgson & Knudsen (2006, p. 9) are the century XVII revolution in England, the Meiji restoration in 1868, and the Japan and German occupation by Americans in 1945. To them (*op.cit.*, 2006, p. 9):“The course of institutional evolution was altered by the intrusion of new forces across the boundaries of the system, as in many other cases of institutional transformation being promoted by invasion or other forces from outside”. This argument emphasize the importance of the Darwinian contribution to the development process involving habits, customs, technologies, institutions and all the economy. We think that this proposition has important effects to the interpretation of Brazilian economic development in the 20th century. This point will be discussed in the next section.

That is the reason why the notion of ‘*reconstitutive downward causation*’ (effects) proposed by Hodgson (2004) is essential to the definition of habits, which will constitute the institutional framework⁴. In a close position is Douglass North, who

⁴ To Hodgson (2004, p. 331-332): “Institution are enduring systems of socially ingrained rules. They channel and constrain behavior so that individuals form new habits as a result. People do not develop new preferences, wants or purposes simply because “values” or “social forces” control them. Instead, the framing, shifting and constraining capacities of social institutions give rise to new perception and dispositions within individuals. Upon new habits of thought and behavior, new preferences and intentions emerge. As a result, shared habits are the constitutive material of institutions, providing them with enhanced durability, power and normative authority. (...) The mechanism through which culturally and institutionally specific rules of cognition and action become imprinted in the human mind is through the formation of habits. All reason, deliberation and calculation depend upon the prior formation of habits.

recognizes the importance of the mental models that perform the economic structure and the institutions. This point suggests a convergence between the new and the old institutionalism, rehabilitating both the concept of endogenous preference and as the individual rationality created culturally and institutionally. This convergence will be treated specifically in the next section suggesting a Veblenian evolutionary ontology. That is the answer why this ontology should be funded in heterodox and evolutionary propositions.

6. Beyond the heterodoxy: an evolutionary Veblenian Ontology

Institutionalism – including Thorstein Veblen, John R. Commons, Wesley Mitchell, Morris Copeland e Clarence Ayres – has a great variety of approaches that induced to different tendencies in terms of philosophical and psychological propositions. For example, Veblen incorporated the psychology of instincts and habits and rejected positivism while Ayres followed a reverse instance. It contrasts with the common and unsustainable view that Ayres was a follower of Veblen tradition.

The ascension of positivism, the decline of the instincts and habits psychology, and the behaviourism ascension in the period of 1900-1930 took the institutionalism to the crises concerning its identity and fundamental presupposition. These crises prevented Commons and others on formulating an adequate philosophical fundament to institutionalism. Such deficiencies are the answer of the subsequent decline of this thought.

However, Veblen's position retrospectively is seen by Hodgson (2006c, p. 218) as strictly modern compared with the recent advances in philosophy, psychology, sociology, anthropology and economy. Veblen was influenced by pragmatist philosophy, which after being eclipsed during all the 20th century re-emerged becoming nowadays one of the most influential philosopher structures in the intellectual scenario (Hands, 2001, p. 214, *apud* Hodgson, 2006, p. 218). After the hegemony of behaviourism in psychology between the 1920s and the 1960s, the evolutionary approaches inspired in William James and others were resurrected. Also the Veblenian concept of habits defined in terms of acquired dispositions re-emerged in the modern

Habits are formed through repeated thoughts or behaviors in a specific type of social setting. Habits are individual neural connections and mechanisms, but they bear a social imprint. Reconstitutive downward causation, from specific social structure to individual, operates by creating and molding habits.”

psychology becoming explicit that Veblen's position is much more viable today while improvements and advances were made in the sense of replacing Kantian philosophy of Veblen by an adequate form of realism.

Hodgson (2004a, pp. 246-247) advances in the sense of proposing the fundamental propositions of the Veblen's institutionalism, identifying six basic negative propositions, in the critical sense - where are included rejection to positivism, methodological individualism and methodological collectivism – added to thirteen basic positive propositions – where are included the principle of universal causation, the principle of evolutionary explanation, and the idea of reconstitutive downward causation. However these nineteen propositions are insufficient to complete all the Veblenian institutionalism. It is necessary to include additional key elements that, despite necessities, “(...) were unclear, underdeveloped or absent in Veblen's works’ I add a further eight propositions (including a layered ontology and an explicit focus on emergent properties) that are ‘vital for a Veblenian theoretical system rebuilt on emergentist foundations’ (HODGSON, 2004, p. 247).” To Hodgson twenty seven propositions schematize partially the philosophical fundamentals of the Veblenian institutionalism. The great part of these propositions is ontological and concerned with the nature of social being, causality, evolution, Darwinian population thought and much more.

The Veblenian institutionalism both in its original form as in the resuscitated form can claim a particular ontology, which contrasts with many others approaches coming from the heterodox and the mainstream. For example, the Veblenian notion of the instinctive intelligence contrasts with the dominant view of the social scientists, such heterodox as orthodox, because both of them saw instincts and intelligence as opposing themselves. Beside, the insistence of Veblen that the assumptions concerning human capabilities should be consistent with the evolutionary explanations (in Darwinian terms) was absence in the great majority of the mainstream and heterodox thought. However, Veblen did not develop and resolve an adequate social ontology. It is important to point out that his Darwinian and evolutionary general instance indicated a potentially fertile ontology which will be realized on the future theoretical works. Partly the resuscitate Veblenian approach is concerned with the algorithmic and incremental nature of the decision making. The orientation of the referred approach is given toward the comprehension of the processes, instead of the equilibrium, as emphasized by Lawson (2005, p. 16). Such the social reality as the individuals capabilities are

conceived in terms of the various systems of procedural rules. In Veblen this system of rules was replaced by a Darwinian generalized structure where the principles of variation, retention and selection were used to explain their evolution.

In this context Hodgson proposes that these elements are convergent with a possible change in the social sciences similar to a “gestalt”, but in an opposite sense of the approaches linked with notions of incremental change and equilibrium of the mainstream. In Hodgson’s words:

“These and similar elements elsewhere coincide with a possible *gestalt* shift in the social sciences, away from conceptions of incremental change and equilibria, where everything potentially impinges on everything else, to a notion of limited interconnectedness within social systems essentially composed of structures and algorithmic processes of rules.” (HODGSON, 2006c, p. 220).

Due to this new gestalt and particularly to the recent development of the new and the old institutionalism what will emerge in the future as ‘institutional economics’ will be very different of what was dominant in the 80th and 90th in this realm. Consequently the trial of delimitating sharply what distinguishes mainstream from heterodox may be useless and unconvincing. In other words, by distinguishing them in ontological presuppositions it will be neglected the fact that all theorization involves some type of enclosure, what become unacceptable the distinction in Lawson’s terms.

Beside, the distinction among the different heterodox approaches departing, not from their respective ontological presuppositions, but from their various interest questions omits the great diversity of fundamental hypothesis of the heterodox economics and the old institutionalism. It omits also the specific ontological focus of the algorithms and rules of the system featured as the modern evolutionary or institutionalism version. And this modern approach has a strong Veblenian root.

7. Deliberate process of institutional change

Given the constitutive role of institutions and the interaction among individuals and institutions, is possible the existence of deliberative institutional change. There is a process of institutional construction that evolves through formal and informal institutions.

The idea of the existence and the deliberate construction of an ideology of industrialization or a developmentalist culture are perfectly plausible. As Hobsbawm

(2013, p. 98) points out, history cannot omit consciousness, culture and intention on institutions created by man.

The process of economic development is not limited to its physical aspects. It involves economic growth and improvement in well-being. But it has implications in the way of the members of the society think, behave and act.

“Institutional building is by no means easy and cannot result in ‘optimal’ outcomes. The process of institutional adaptation and innovation is an uncertain process, and it is by no means clear that what the state thinks are ‘good’ institutions will in fact be good for the society. Nevertheless, this does not mean that such an attempt at institution building should be abandoned, for such problems are common to all cases of adaptation and innovation, whether they be technological or organizational or performed by business enterprises or by the state. Another difficulty in the process of institution building is the possibility of many conflicts, partly owing disagreements over the acceptable distribution of property (and other) rights that will result from the new institutions and partly owing to the fact that different institutional structures have assorted implications for various objectives (growth, equity, efficiency), which groups value differently. Such conflicts can easily thwart institutional changes that bring about improvements. To summarize, the uncertainty and the conflicts inherent in the process of institution building mean that, although necessary, institution building by the state (or for that matter by anyone) cannot be expected to produce ‘optimal’ outcomes.” (CHANG, 1999, pp. 195-196)

Hobsbawm and Ranger show that many cultural “traditions” have been “invented” through conscious effort (CHANG, 1999, p. 196 n.r.). “Traditions which appear or claim to be old are often quite recent in origin and sometimes invented”. (HOBBSAWM, 1983, p. 1). Chang (2007) also shows that culture changes. Industrialization, with rapid structural transformation of society, contributes to it.

In the case of economic development, it has a symbolic dimension. Structural change of society contributes to cultural change through a discourse that encourages industrialization, reinforcing the process.

After present the concept of the constitutive role of institutions on economic development, it will be applied to Brazil during 20th Century, with focus on Vargas government.

8. Institutional change in 20th Century Brazil

Institutions are result of its own history. Development is path dependent. Every individual and every society carries the baggage of its past (HODGSON, 2001, p. 3). Economic history also provides a lot of insights. During the 20th Century, Brazil experienced a radical structural change. There were modernization and industrialization.

“For those who are interested in the study of the relationships between institutions and economic development, the Brazilian experience in the last half century is a crucial one” (BURLAMAQUI, SOUZA, & BARBOSA-FILHO, 2007, p. 255). Brazil in the 20th Century offers some examples that will be analysed: creation of organizations (Public Owned Enterprises, Universities, Research Institutes); changes in law; changes in the “ideology” (attitude towards economic development). Fonseca (2003) list the organizations created during Vargas administration. Many of them directly or indirectly linked to industrialization.

Burlamaqui, Souza, & Barbosa-Filho, focused on the period post Second World War. Indeed, this is a period of extraordinary growth of the Brazilian economy. Despite we will analyse some examples from Vargas administration, both prior (1930-1945) and after (1951-1954) to the war. The basis of the Brazilian Developmental State was built during the Vargas Era (BURLAMAQUI, SOUZA, & BARBOSA-FILHO, 2007, p. 241).

The process of industrialization in Brazil begins in 1930. Getúlio Vargas reached the power as a revolutionary leader in 1930. He was elected in 1934 and became a dictator in 1937. In 1945 he left the presidency. Thereafter in 1951 he came back as an elected president until his suicide in 1954.

Furtado classical interpretation stresses that the policies adopted in protection of coffee production stimulates the industrialization of Brazil through cambial devaluation, expansionary monetary policy, and burnt of coffee stocks that keeps aggregate demand. Furtado’s initial argument saw industrialization as a by-product of those measures. Fonseca (2003) showed the intention of the Vargas administration toward industrialization during the decade of 1930.

The Revolution of 1930 is a mark on the rise of developmentalism in Brazil. This context of institutional change was a moment of a “critical juncture” to utilize Acemoglu and Robinson (2012) terminology. It is possible to describe clearly 1930 as an example of institutions altered by the intrusion of new forces across the boundaries of the system, mentioned above by Hodgson & Knudsen.

The process which begins with Vargas involves structural change of Brazilian society. There was a shift of dynamic centre from agriculture to industry, from exports to domestic markets (FONSECA, 2011). There were the creation of institutions and organizations. The changes were technological, organizational, and cultural.

Fonseca (2003, pp. 144-147) provides a list of organizations created by Vargas administration. Among organizations directly and indirectly oriented to industry, we highlight the following:

- a) Ministério do Trabalho, Indústria e Comércio (Ministry of Labour, Industry, and Trade, created in 1930);
- b) Reform on education, started in 1931, focusing on technical and vocational education, and on areas related to production, like engineering, agronomy and accounting;
- c) Carteira de Crédito Agrícola e Industrial no Banco do Brasil (Agricultural and Industrial Loan Portfolio at Banco do Brasil, 1937);
- d) Modernization of Public Administration (DASP, Administrative Department of Public Service, 1938);
- e) Companhia Siderúrgica Nacional (National Steel Company, 1941);
- f) Companhia Vale do Rio Doce (Mining Company, 1942);
- g) SENAI (National System of Industrial Learning, 1942);
- h) Labour legislation (CLT, the Consolidation of Labour Laws, 1943);
- i) SUMOC (Superintendence of Money and Credit, a prototype of a central bank, 1945);

Further on organizations created between 1930 and 1945, on his second period (1951-1954), another set of organizations orientated towards industrialization and economic development:

- j) CNPQ (National Research Council, 1951);
- k) Petrobrás (Brazilian oil company, 1953);
- l) BNDES (National Bank of Social and Economic Development, created in 1952, then called BNDE);

The institutional change is not limited to Vargas government. There are examples of other governments, as result of the same institutional framework that could be analysed on further researches: SBPC (Brazilian Society for Progress of Science, from 1948, in Dutra government, supported by Vargas); expansion of Universities, during Juscelino Kubitschek government; Eletrobras (electric energy company), proposed by Vargas, but created during João Goulart government; Embrapa (Brazilian enterprise of agricultural research), during military dictatorship.

Also is important the creation of an attitude favourable to developmentalism and industrialization. The deliberate institutional change was not limited to formal

organizations. A favourable attitude towards economic development was created. The ideology of development also played a critical role.

The concept of reconstitutive downward effect is crucial to understand the evolutions of institutions in Brazil. There was a change on the structure of society as well as a discourse favourable to it. There were discourse, ideology and economic theory⁵ supporting industrialization and shaping worldviews. This discourse helps to shape habits and mould individual behaviour. Individuals act according to a new worldview, acting in a manner contributing to industrialization, reinforcing it.

The Vargas Era in Brazil was a period of profound structural changes, from an agrarian economy to an industrializing one. After the process, the mental model shared by the population, the habits, and the structure of the society were completely different.

9. Final Remarks

The process of economic development is a process of institutional change. The possibility of deliberate institutional change has to be considered. However it is usually underestimated. Understanding the process of institutional change implies in understanding the role of institutions.

Is fundamental to reassert the importance of go beyond the rhetoric of constraints. Institutions can enable and constitute economic development. It analysis have to consider the theoretical basis of Veblen and Commons. The propositions of Darwin led to a Veblenian ontology. This ontology with the framework developed by Hodgson allows interpreting the process of economic development from the constitutive role of institutions. The reconstitutive downward effect describes the relation between individuals and institutions. Hence, economic development has to be described as an evolutionary process where institutions play a fundamental role constituting it.

The historical example from Brazil during Vargas Era shows that is possible a reinforcement between formal and informal institutions towards an institutional change. There was deliberate institutional change with an active role of the State. This analysis can be replicated to other developmentalist governs in Brazil and other Latin-American countries.

⁵ Mainly in post-war period, with the creation of ECLAC (Economic Commission for Latin America and the Caribbean) and the rise of developmentalist economists, like Celso Furtado. Notwithstanding, Fonseca (2000) provides the theoretical roots of ECLAC that were present in Latin America before his creation.

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