

INSTITUTIONAL ECONOMICS AND CONSPICUOUS SCIENCE¹

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Abstract

American Institutionalism is criticized for not delivering a theoretical contribution to Economics. Williamson called Veblen and other American Institutionalists as old institutional economics and, in opposition, denominated his contribution – with North, Coase and others – as new institutional economics. In this denomination, there is an idea of discontinuity between these two schools of thought and an implicit conception of science. On the one hand, new institutional economics is authorized to handle with institutional issues in Economics. On the other hand, old institutional economics was relegated at most to a chapter in the history of economic thought. The purpose of this article is to put in perspective the concept of theory construction, implicit in the new institutional economics' criticism of American institutionalism. It is argued that new institutionalists may be practicing a conspicuous science. In this sense, new institutionalists seem to have a necessity of scientific emulation, visible in their non-critically adherence to mainstream ontology. The aim of this article is to show how the diverse conceptions of institutions are rooted not only in distinct schools of institutionalist thought, but also in different philosophical ontologies. This is an important issue, once science is socially recognized as a vehicle of truth and if we still think that truth has some relevance in science and life, the ontological roots of economic theories must not be neglected. The article is divided in three sections plus an introduction and a conclusion. In the first section, some conceptions about theoretical construction are shown through the debates in Philosophy of Science, from logical positivism to critical realism. The second section is focused in American Institutionalists' conception of institutions, in which I give more attention to Veblen ideas. In the third section, new institutional economics is presented, focused in Coase and North theoretical proposals.

Keywords: American institutionalism, new institutional economics, conspicuous science, ontology, scientific research program.

¹ WINIR 2017, 14-17 September, Utrecht University, Utrecht, Netherlands.

NEW INSTITUTIONAL ECONOMICS AND THE CONSPICUOUS SCIENCE

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“Science grows out of life, and in life itself, whether we realize this or not, we have spontaneously to behave ontologically. The transition to science can make this tendency, which is itself unavoidable, more conscious and critical, but it can also weaken it, or even make it vanish.” (Georg Lukács)

Introduction

American institutionalism is very often criticized for not having delivered a robust theoretical body. New institutionalists, like Oliver Williamson, Ronald Coase and Douglass North, named Veblen and his intellectual heirs as old institutionalists. This demarcation expresses the idea of a non-continuity between those two schools of thought and an implicit conception of science. The new institutional economics (NIE) claimed to be the legitimate theory of institutions within Economics. The so called old institutional economics (OIE) was relegated at most to a chapter in the history of economic thought. This article's purpose is to consider the very concept of theory construction, implicit in the new institutional economics' criticism of American institutionalism. It is argued that the new institutionalists seems to be engaged in a conspicuous science, inspired in Veblen's concept of conspicuous consumption and emulation.

To handle the differences between new institutionalism and American institutionalism, we must consider the difference between heterodoxy and orthodoxy. There are many attempts to distinguish orthodoxy from heterodoxy. I follow the etymological definition of orthodoxy as the “straight opinion”² and heterodoxy as the “different opinion”³, which is compatible with the idea of a positive heuristic and negative heuristic, respectively, in Lakatos' concept of research scientific program (RSP). Instead of searching core concepts that distinguish them, I propose to look at the purpose of scientific construction. Then I propose that while heterodoxy has an ontological orientation, orthodoxy is engaged in what I call a conspicuous science.

But, what means to have an ontological orientation? It means, at a first approximation, the search for truth. If science is considered the vehicle of truth it is not odd to think scientific construction to be aimed at the search for truth. It means realism. But logical positivism was realist in the sense that truth was important. Nonetheless, the failure of its anti-metaphysical project led to an instrumental conception of scientific

² “Late Middle English: from Greek *orthodoxos* (probably via ecclesiastical Latin), from *orthos* ‘straight or right’ + *doxa* ‘opinion’.” Source: <https://en.oxforddictionaries.com/> (access: 04/07/2017)

³ “Early 17th century (originally as a noun denoting an unorthodox opinion): via late Latin from Greek *heterodoxos*, from *heteros* ‘other’ + *doxa* ‘opinion’.” Source: <https://en.oxforddictionaries.com/> (access: 04/07/2017)

construction, in which truth is abandoned. Other unfolding of philosophy of science debates were the denial of an ontological basis of comparison between theories, which is clear in the Kuhnian faith criterion or the predictive theoretical evaluation proposed by Lakatos. In logical positivism truth exists, but only in empirical, sensitive, dimension, in instrumentalism truth cannot be obtained, because an absolute reconstruction of reality is impossible, and in Kuhn and Lakatos conception, theories builds different incommensurable truths. That's why talking about ontology is urgent in nowadays scientific construction.

But what kind of truth are we talking about? Identifying ontology with truth, or the search for truth, does not mean that I am claiming an absolute and unquestionable truth, once science is made of critical approaches and theories concerning reality. So, there is not an untouched (by thought) world that can be discovered or enlightened by the right theory. Nonetheless, there are theories that captures more objectively processes and properties of reality. But to recognize that an objectivity in this sense is possible we need to understand reality in the dimensions suggested by Bhaskar (1997). If we understand reality as made only by empirical objects, science, of course, will never reconstruct all the messy and endless aspects of all empirical objects in time and space, so science will never apprehend the complexity, the reality, of the world. To understand reality as divided in three dimensions – empirical, actual and real – makes the scientific work intelligible and possible.

If at this point we agree that this objective truth is something that science can grasp by means of theory, we may ask if the search for truth is a natural or social determination. In other words, our search for a true understanding of reality is something inherent to our being or is it a social construction? I think that in social science we have these two determinations. Here I need to make a succinct digression about the so called natural world and the social world. Some authors, like Marx (n.d. [1867]), Engels (n.d. [1876]), Lukács (1980) and more recently Bhaskar (1998), works with the category of emergence. In this way, the organic world of plants and animals emerged from the inorganic world, likewise, the social world emerges from this organic, purely natural, world. The point is: what makes us different from other animals? Language? Cooperation? Thought? Labor? Depending on the author, the answer may be different. What Engels, Marx and Lukács suggested is that the category of labor is at the origin of this emergence, once labor is the exchange between men and nature. Moreover, humans can only act in the world by means of apprehending reality in thought. Note that to apprehend reality in thought is not just a capacity that we have as a species, but it is an ontological characteristic of human beings, of social beings. It is not a choice to act this way, it is the only way we can act in the world.

What means to act ontologically? Simply state, to act ontologically is to act in accordance with the properties of the world to make the result of that action successful. If I need to eat in the jungle I probably will not jump in the first moving animal and bite it, probably I will have to try to understand – it means to grasp in thought – the environment that I am into and try to build some strategy of action. The range of strategies and the complexity of them will depend on the social environment from which this lost individual came from⁴. The first hunters and gathers didn't have the knowledge that an urban individual that goes to an adventure in the jungle has today, hence their experience certainly would be different. But these two individuals separated by thousands of years has something in common: they must figure in mind the reality they are acting on, despite the range of knowledge they have about objects in the world, and knowledge is always

⁴ Not even Robinson Crusoe behaved in a completely instinctive basis, it was his social abilities that made his survival possible.

social. So, if medical sciences do not grasp correctly the functioning of a human body, probably doctors wouldn't be able to heal diseases. Of course, if medicine was not aimed at truth it probably would be called an act of faith, not science. If engineering was not aimed at an objective understanding of the world, probably we wouldn't have space travels, skyscrapers and other things that would be impossible without an ontological orientation of natural science.

However, in social sciences, and in Economics specially, we do not only see the denial of an ontological orientation, but also its logical conclusion, that is, if we cannot know reality we must simply grasp some contingent regularities in theoretical (abstract) models. Curiously, the only realm – the social realm – that we can really change, although not in a voluntarist way, is taken as immutable and unknowable. In some sense, because of that, we take natural world as completely controllable by technology, despite the many signals that the planet gives us that natural resources does not support endlessly our current mode of production and consumption.

Therefore, to act ontologically is our way of being and distinguishes us from other animals. This is Lawson's (1997) concept of human intentional agency, that is, to act in the world, we must have some knowledge of the world, which implies the preexistence of enduring social structures, which means that human action is not incidental, it is ontologically oriented. But, even though our action is ontologically oriented, in this sense truth oriented, we can build false discourses about reality. Social world emerges from the natural world, but is not definitively determined by our natural basis. As Veblen (1899) has noted, in the process of development of society habits of thought can gain some primacy over instincts and, sometimes, we can act guided by habits of thought against our basic instincts. If one think that it is a matter of group approval to drink more than anybody else, this individual can end up dying in his attempt of social emulation. In this case, a habit of thought is more guided by behavior than by a survival instinct. The idea of a theory of instinct may be wrong, but Veblen shows us something interesting, that is, human beings can construct conceptions and rules that can be in disarray with ontology, or the real properties of the world. If the cognitive world was an exact mirror of reality we would not have this kind of disarray, we would act always automatically oriented by instincts, so we would have been just another animal species in the world, society would never has emerged. Thus, being a human has these two aspects, namely, we can build things that no other animal can do, but we can also create false conceptions about reality that may potentially kill ourselves, something that other species cannot do.

1. Debates in Philosophy of Science

In this section, I will briefly present some debates in philosophy of science to clearly state the philosophical ontology suggested in this article. Since Economics has turned itself on a theory of choice it has been criticized for being unrealistic in its assumptions. Friedman's instrumentalism states that realistic assumptions are not needed because they are not obtainable. But instrumentalism is a consequence of the adoption of a logical positivist ontology.

The main proposal of logical positivism of the 1920's was to build a scientific discourse free from metaphysical statements; and the discourse should be common to social and natural sciences alike. In this discourse, only tautological statements or with empirical content would be meaningfulness (or cognitive significant), therefore, scientific. It soon became evident that an application of those positivist prescriptions would exclude universal laws, broadly used in natural sciences, once they could not be verified empirically. Since a conclusive verification of a proposition would imply endless

empirical tests, it became impossible to adopt such a demarcation criterion between scientific and non-scientific propositions.

Popper was one of the critics of logical positivism, stating that in the eagerness to eliminate metaphysics, they end up eliminating science itself. Popper also suggested falsifiability as an alternative to verification; if it is not possible to conclusively verify the meaningfulness of a statement, it is possible to say that a theory is false. Then, Popper suggested a procedure to be adopted by all scientists in which they should never think they have the true theory, but a temporally true theory that can always be falsified by the empirical evidence. Popper acknowledges metaphysics as an ineliminable feature of science. Likewise, the growth of knowledge tradition also recognizes that metaphysics cannot be eliminated from the theoretical construction.

The most quoted authors in growth of knowledge tradition are Thomas Kuhn and Imre Lakatos. This philosophical tradition is characterized by an emphasis on the social and historical aspects of scientific knowledge, which implies the abandonment of a logical positivist conception of the scientist as a mere data processor. The metaphysics reappears in the Kuhnian conception of paradigm and in the Lakatosian conception of hard core and research scientific program (RSP). The problem is that the criterion of choice between paradigms ends up in a faith criterion or in a rationalistic criterion based in the test of the predictive power of RSP's theories. In one hand, there is no criterion of choice at all, as faith is not exactly a feature of science, and on the other hand we end up, again, in an empirical criterion for science. Kuhn and Lakatos build a more sophisticated notion of scientific construction, but they fail to deliver a rational judgment criterion of choice between competing theories. As a result, we end up with an ontological relativism. Critical realism tries to show that an epistemological relativism does not need, necessarily, to end up in an ontological relativism.

Critical realism is a tradition in philosophy of science headed by Roy Bhaskar and was widespread in Economics by Tony Lawson. It suggests a reassessment of ontology, in the sense that every theory has an underlying ontology, or world view, and all theories and ontologies can and have to be compared. In his book "Economics and Reality", Lawson (1997) criticizes the economic mainstream for being comprised with a methodology that he called deductivism, which is based on a positivist ontology. Deductivism is a method of scientific investigation that understands scientific laws as constant conjunctions of events of the form "if x then y". Underlying this method there is an ontology of atomistic empirical objects of experience, a positivist ontology.

Critical realism suggests an ontology based in transcendental realism, which does not limit the objects of science to empirical facts, but tries to bring into light the laws and mechanisms that underlies the actual events. This philosophical ontology understands that we can only have access to laws and mechanisms through actual events, but science's work does not end in the search for empirical regularities. Bhaskar, followed by Lawson, suggests the conception of a reality stratified in three levels: empirical, actual and real. This ontology demands another method of investigation, distinct from deductive or inductive methods, proper of mainstream economics, comprised with a positivist ontology. This method suggested by critical realists was called retroductive, and consists in the attempt to bring into light and understand the laws and underlying mechanisms that engenders the actual events.

Transcendental realism is a richer philosophical ontology that enables the construction of an objective knowledge about society. Moreover, the retroductive mode of inference permits the elaboration of objective abstractions of reality's constitutive parts. This is not possible in an instrumentalist philosophy of science. In the article "The Methodology of Positive Economics", Friedman (1953) states that a realist theory of

society is impossible, because, for him, realism means exhaustive description of empirical elements of the reality under investigation. Of course, this absolute reconstruction of reality in thought is impossible. By identifying objective knowledge with absolute knowledge, Friedman concludes that an objective, true, realistic, knowledge about society is impossible and all that science can do is formulate unrealistic assumptions about reality. In addition, those assumptions must be able to provide accurate predictions about future events in the same way that they are used to verify hypothesis about the economic past. This is a specific comprehension of economic history called cliometrics, concerned with the collection of empirical evidence to verify a hypothesis about the economic past or to use empirical evidence to forecast future events. Again, an atomistic ontology is present.

Taking the meaning of heterodoxy, and observing the effective work of heterodoxy, the philosophical ontology proposed by critical realism seems to be more adequate to underlie heterodox theories; and we can also observe this philosophical ontology in heterodoxy, being the authors aware of that or not. Likewise, deductivism is easily identifiable in orthodoxy theories. We can observe these two philosophical ontologies in operation in Veblen and North, for example. But if deductivism has its flaws and seems not to be a good underlying ontology for science, why this methodology is so widespread in Economics? It is not possible to say that in Economics we do not have an alternative, considering the multiple theories suggested by heterodox authors and the realist philosophy of science proposed by critical realism. Therefore, we may ask ourselves if mainstream economists are not engaged, consciously or not, in an emulation activity? Aren't mainstream economists engaged in which I called, inspired by Veblen, in a conspicuous science? In the next section, the Veblenian critique to the late nineteenth century orthodoxy will be considered. The concept of emulation and conspicuous consumption will also be presented.

2. Thorstein Veblen: the rise of American Institutionalism and the critique of orthodoxy

This section has two purposes: (i) introduce the Veblenian critique to orthodoxy; (ii) present the concept of emulation and conspicuous science. In this way, we will be able to understand the intellectual environment of Veblen's thought and to introduce the concept of conspicuous science.

In the late nineteenth century, Veblen wrote an article entitled "Why is Economics not an Evolutionary Science", first published in 1898 in *The Quarterly Journal of Economics*. In this article, Veblen criticized the economic orthodoxy. Veblen did not only criticized orthodoxy, identified with John Bates Clark's neoclassical conceptions, but also criticized a wide range of authors and schools of thought, such as Karl Marx, Adam Smith, Austrian economics and German historical school, in a series of articles published between 1899 and 1900 in *The Quarterly Journal of Economics* (Cavaliere, 2013, p.46). First, I will focus on the critique directed by Veblen to economic orthodoxy in his 1898 article – "Why is Economics not an Evolutionary Science".

Veblen identified a non-evolutionary science with the orthodoxy of the late nineteenth century, stating that "economics is helplessly behind the times, and unable to handle its subject-matter in a way to entitle it to standing as a modern science." (Veblen, 1961 [1898], p.56) Economic orthodoxy incurred in three misconceptions: animism, hedonism and taxonomy. Veblen's critique intended to overcome this non-evolutionary conception of science and build a post-evolutionary economic science, in line with the most recent psychological and evolutionary theories. According to the author, an

evolutionary science “is a close-knit body of theory. It is a theory of a process, of an unfolding sequence.” (Veblen, 1961 [1898], p.58).

An evolutionary science must be engaged in an explanation of a sequence of cause and effect, unlike the non-evolutionary explanation of economic phenomena, in which explanation was always produced in terms of a purpose, which leads to animism, or a teleological conception of economic events. According to Veblen (1961 [1898]), animism can be found in Adam Smith’s conception of self-interest and invisible hand as means of welfare promotion. Other theoretical element identified with a non-evolutionary science is a system of economic taxonomy, that is, “a body of logically consistent propositions concerning the normal relations of things” (Veblen 1961 [1898], p.67). Taxonomy were also present in the German historical school, that applied an inductive method, and in Classical and Austrian economics, committed to a deductive method of reasoning. If in the inductive method data is observed without theory, in deductivism, theory is gathered without empirical reference. Veblen’s suggestion was the adoption of an abductive method of reasoning and theoretical construction (Hodgson, 1994, p.61).

The last complaint Veblen directed to non-evolutionary science, in which orthodox economics was included, was concerned with the comprehension of the economic agent. Economic orthodoxy had a hedonic comprehension of the human subject, defining the economic agent as a “lightning calculator of pleasures and pains” (Veblen, 1961 [1898], p.73). Instead, Veblen suggested an instinct psychology to underlie human action, which would be based in three basic instincts, beyond the survival instinct, they are: workmanship, parental bent and idle curiosity. Furthermore, Backhouse (1985, p.227) draws attention to the fact that a hedonistic psychology of economic action implies a conception of exogenous preferences, while Veblen would have considered individual preferences as shaped by institutions.

Therefore, instead of a non-evolutionary science comprised with animistic and taxonomic theoretical construction, “an evolutionary economics must be the theory of a process of cultural growth as determined by the economic interests, a theory of a cumulative sequence of economic institutions stated in terms of the process itself” (Veblen, 1961 [1898], p.77). In lieu of an animistic and taxonomic theoretical construction, the economic scientist, comprised with an evolutionary science, must explain economic reality considering the chains of cause and effect in complex and historical interaction, between institutions and human instincts, in the evolutionary process of economic life. But what are institutions and what human instincts are those?

As we pointed out above, Veblen recognizes the survival instinct, the one that keeps us alive, and other three basic instincts: (i) workmanship, a drive for technological improvement; (ii) parental bent, a drive towards providing the welfare of family and society; (iii) idle curiosity, a drive to produce coherent explanations of the world (Backhouse, 1985, p.227). These are all drives to human action, but more important than instincts were institutions, which gained relative autonomy over instincts through time.

The institutions are, in substance, prevalent habits of thought with respect to particular relations and particular functions of the individual and of the community; and the scheme of life, which is made up of the aggregate of institutions in force at a given time or at a given point in the development of any society, may, on the psychological side, be broadly characterized as a prevalent spiritual attitude or a prevalent theory of life. (Veblen, 1899, p.88)

Further, Veblen continues:

Any community may be viewed as an industrial or economic mechanism, the structure of which is made up of what is called its economic institutions. These institutions are habitual methods of carrying on the life process of the community in contact with the material environment in which it lives. (Veblen, 1899, p.89)

Veblen is suggesting that in carrying on the life process, individuals develop habits of thought, or ways of doing and thinking about things. And it is important to note that Veblen could only consider institutions through habits of thought and could only take habits of thought into account when he modified the conception of human nature from hedonism to an instinct based psychology. Even if the habits of thought are embedded on material life, we can see Veblen's theory of institutions as ultimately rooted on psychological models. Although the author is not focused on isolated individuals, he begins by modifying the behavioral conception of human action, likewise North's modification in the assumption of rationality.

Thereafter, Veblen define institutions as habits of thought. To exemplify the idea of an institution as a habit of thought, we can mention two habits of thought identified by Veblen, namely, the business enterprise and the machine process. With the replacement of the "craftsmanlike skill" by the "mechanical standardisation" men were led to think in terms of cause and effect due to their way of life, and this way of thinking is quite different of the business enterprise habit of thought, based on a pecuniary gain motive (Backhouse, 1985, p.223). These are habits of thought observed by Veblen at his time. All along the "Theory of the Leisure Class", first published in 1899, Veblen traces back the origin of conspicuous consumption in primitive instincts that led to power emulation, expressed through fight and other animated activities as hunting and war.

Veblen identifies three stages of evolution in society: predatory, quasi-peaceable and peaceable. In the predatory stage there is no property, division of labor is defined by gender, and individuals live in a phase of social development identified with savagery. In quasi-peaceable stage, property emerges, division of labor is determined by the social class to which individuals pertain and barbarism is the phase of social development. The peaceable stage is identified with capitalism, in which we have private ownership of goods and an industrial system based on wage labor (Veblen, 1899, p.35). Veblen's main concern in "The Theory of the Leisure Class" is the understanding of the emergence of the leisure class and its reproduction mechanisms. According to Veblen, the leisure class emerges in the passage from savagery to barbarism. In this passage, three aspects are worth noting: fight, subsistence, and division of labor. In savagery, subsistence is not guaranteed, but it is in barbarism, in which also emerged appreciation of fight, consequently, the activities related to hunting and war.

In the transition from a peaceable to a warlike habit of life the leisure class emerged (Veblen, 1899, p.5). This transition also marks the emergence of the instinct of workmanship together with the necessity of emulation. With subsistence guaranteed, the basis for the emergence of a leisure class is posed and, along with it, the need to demonstrate belonging to this social class in opposition to inferior classes, occupied in subsistence activities. The motivation for emulation is people's need for social approval. Although the leisure class has emerged in barbarism, its effectiveness occurs with the emergence of conspicuous leisure. In barbarism, this free time is spent with hunting and war; with the advent of conspicuous leisure, this free time is appreciated in itself.

One can demonstrate that is not engaged in subsistence activities, pertaining, therefore, to the leisure class, through conspicuous leisure and conspicuous consumption. Conspicuous leisure is shown through etiquette and erudition, both demanding time, money, and social contact. Conspicuous consumption is shown through ownership of goods. Clothes are a good example. Some people are more worried about the social

evaluation of the dressing style than with the comfort of the cloth. The point with conspicuous consumption is not directly the use value of the good, but the social approval of the consumption of that good. Consumption is not aimed to the goods' usefulness, but to the emulation that stems from the ownership and use of those goods. In this sense, does not matter what a good is, all that matters is how society evaluates you when in possession of this good. Therefore, emulation is a way of demonstrating belonging to a specific social group.

In Veblen's work, we can note a sociological, anthropological, in one word, a interdisciplinary approach. He is not worried about being considered part of a scientific tradition, he is claiming another conception of the social world, in this sense, Veblen is suggesting another social ontology. It is also noted that, for Veblen, economics' subject matter is not based on a narrow definition of the economy as a struggle for scarce resources, which could be a lot of things, like "two dogs fighting over a bone or two schoolboys fighting over a ball" (Searle, 2005, p.1). Instead, the subject matter of economics is understood as a complex set of human relations, both material and psychological. Here we can signal that Veblen did not criticize orthodoxy only for its theoretical deficiencies, but he also pointed out the need to consider the subject matter of economics more broadly. Curiously, the current orthodoxy, identified with the neoclassical research program, receives virtually the same critique from what became known as post-autistic economics movement⁵. In the next section, the new institutionalism is presented as the neoclassical branch of institutionalism in Economics.

3. New Institutional Economics

The seminal contributions to new institutionalism are usually credited to Ronald Coase, Oliver Williamson and Douglass North. Williamson denominated this school of thought as New Institutional Economics (NIE) in opposition to American Institutionalism, now called Old Institutional Economics (OIE). In 1937 Coase published the article "The Nature of the Firm", in which he questioned the mainstream conception of the firm as a mere function of production and the absence of transaction costs in the economic system. Coase claimed more realism to Economics, but realism was not enough, the theory must also be tractable. But what Coase understood by realism and tractability?

Coase (1991, p.2) affirmed that economists was engaged in a "blackboard economics", an unrealistic theoretical construction that considered the firm as a black box. To understand why firms exist and what they are would bring, in Coase's conception, more realism to the theory. Furthermore, to consider those issues within the principle of substitution at the margin guarantees tractability to the theory. So, realism is not enough to meet the scientific criterion. In Coase's view, to be scientific, the theory must also use a specific method of investigation, in his words, theory must be tractable. The question is not only what is a firm or what are its properties that permits our knowledge about it. Besides the call for realism, there is a demand for specific theoretical instruments that makes those theories scientific. The problem, of course, is not to demand a scientific method, but to reduce the possibility of knowledge to a specific method.

Similarly, North's proposal is made within the neoclassical research program, stating that its theories are incomplete and needs more realistic assumptions, retaining the analytical tools of microeconomic theory, that is, substitution at the margin. To bring more realism to Economics, North suggests a modification in the assumption of

⁵ For more about the post-autistic economic movement see: <http://www.paecon.net/HistoryPAE.htm>.

substantive rationality to an assumption of limited rationality to accommodate institutions within the theory; also claiming the consideration of time and evolution in Economics. In fact, North asserts that in a world of substantive (or instrumental) rationality, institutions would not be necessary at all.

In the world of instrumental rationality institutions are unnecessary; ideas, ideologies, myths, dogmas don't matter; and efficient markets, both political and economic characterize societies. But in the real world the actors have incomplete information and limited mental capacity by which to process that information. In consequence they develop regularized rules and norms to structure exchange. (North, 1993b, 159-160)

Therefore, North adopts Simon's conception of bounded rationality, that is, the incapacity of the human mind to take into account "all the relevant aspects of value, knowledge and behavior for every single decision" (Rizzello, 1999, p.44). In this conception, institutions end up being a mental complement to a limited computational capacity of data processing. If reality is messy and the human brain cannot process all the information needed to maximization, institutions works as a system of rules that save some mental processes, helping in choice making.

In which concerns time and evolution, North follows the conception of economic history implied in Cliometrics. According to North, economic history studies the causes of economic growth, decline and stagnation, and the welfare of different groups in a society through time. Thus, the focus of economic history may be the structure of economic organization and the relation between economic structure and performance through time (North, 1977, p.187-188). The author opposes his conception of economic history to that sustained by the *Annales* school⁶. To pose clearly the difference, *Annales* school was denominated as Old Economic History (OEH), while Cliometrics was denominated as New Economic History (NEH).

For the new economic historian, explanation entails the application of the principles of scientific explanation derived from the natural sciences. It entails the use of formal theoretical models based on a limited number of variables. The old economic historian, on the other hand, immerses himself in complex and detailed description of past events. (North, 1977, p.190)

NEH is focused on events and group behavior, not particular events, which allows the use of "simple theories which can produce predictable and specific results rather than indeterminate consequences" (North, 1977, p.188). This is the advantage of NEH: to produce testable and refutable models. The main distinction between OEH and NEH is the adoption of neoclassical methods, that is, the analytical tools of microeconomics. Besides a critique to the lack of realism in neoclassical theory, North (and also Coase) does not goes beyond the protective belt of neoclassical research program. Note that he does not criticize core neoclassical concepts like scarcity and the rationality assumption.

The analytical framework is a modification of neoclassical theory. What it retains is the fundamental assumption of scarcity and hence competition and the analytical tools of microeconomic theory. What it modifies is the rationality assumption. What it adds is the dimension of time. (North, 1993c, s.p.)

⁶ Annales School emerged from Marc Bloch and Lucien Febvre's ideas through the *Annales* journal in 1929. Author's proposals concerned the construction of problem-history conception, alternative to positivist history.

In which concerns scarcity, the author is in line with neoclassical ontology, that portrays the economic system as a world of scarce resources within which individuals fight for those resources and make choices limited by some constraints. *Choice* is a category concerning individual behavior, while *scarcity* tells us something about the constitution of social structures. If the resources of the economic system are scarce, the allocation of those resources imposes itself as a legitimate theoretical problem. The presence of scarce resources implies that the means of production are given and cannot be created, because if they could be created endlessly individuals would have abundance instead of scarcity. Therefore, scarce resources can only be *allocated* or *reallocated*, never *created* by individuals. Within this world view, it is possible to understand the neoclassical emphasis in individual behavior and preferences to explain the economic system.

North also suggests the use of the analytical tools of microeconomics, that is, maximization under restriction, which implies marginal calculation. Those analytical tools are compatible with the ontology portrayed above, that is, individuals make choices (optimization, while they are rational) between scarce resources (constraint). This ontology also permits mathematical formalization, a requisite for the scientific status within mainstream economics. In consumer theory there are indifference curves, reflecting individual preferences that are going to be optimized under a budget constraint imposed to individuals by their wealth⁷. Analogously, in North's institutionalist theory, institutions provide the restrictions within which individuals make their choices. According to the author, to define "institutions as the constraints that human beings impose on themselves makes the definition complementary to the choice theoretic approach of neoclassical economic theory" (North, 1990, p.5).

Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change. (North, 1990, p.3)

In this definition, North points out two aspects concerning institutions, namely, its composition and its role in the evolution of societies through time. In which concerns its constitution, North defines institutions as the "humanly devised constraints" that shapes human interaction. In this sense, institutions provide the rules of the game in which players – individuals and organizations – make their choices. Institutions "define and limit the set of choices of individuals" (North, 1990, p.4), through the imposition of formal and informal constraints⁸. Formal constraints are the codified rules that people conceive, as laws and constitutions, while informal constraints are conventions and codes of conduct self-imposed by individuals (North, 1990, p.4).

In which concerns evolution, North claims that a change in the institutional constraints *mold* the way a society evolves through time. Informal constraints are originated in information transmission through generations, that is, they are the cultural

⁷ This theoretical construction can be found in Microeconomic textbooks. See, for example, Varian (2009).

⁸ Hodgson (2006) calls attention to a conceptual imprecision in terms used by North to define institutions. For example, North (1993c) says that institutions are made of *formal constraints* and *informal constraints*, while in North (1991, 1993a, 2005b), institutions are defined as *formal rules* and *informal constraints*. Furthermore, in North (1997a, 2005a), the author refers to *formal rules* and *informal norms*. In North (2005a), the author uses the terms *formal institutions* and *informal institutions*. To avoid more complications, I use the terminology *formal constraints* and *informal constraints* throughout this article.

heritage of a society. Therefore, using the same formal restrictions in distinct societies may not have the same result (North, 1990, p.36-37). The underlying idea is that individuals that belong to different societies will have distinct mental models, once they live in different cultures, which will lead them to process information in distinctive ways. But this assertion is only possible if the rationality assumption is modified, once individuals processing information are not considered within the limits of substantive rationality.

Therefore, the function of institutions in this economic system is to constrain human action, a usual problem of optimization under constraints. But, although this emphasis on the constraints that institutions imposes to human action, North also recognizes other motives to action and choices, like ideology, that works as a moral evaluator capable of changing a rational individual choice.

By ideology I mean the subjective perceptions (models, theories) all people possess to explain the world around them. Whether at the microlevel of individual relationships or at the macrolevel of organized ideologies providing integrated explanations of the past and the present, such as communism or religions, the theories individuals construct are colored by normative views of how the world should be organized. (North, 1990, p.23)

So, in North's theory, the (bounded) rational individual makes choices within an institutional framework, where those choices are based in rational calculations (rationality) and in moral evaluations (ideology). For example: if you find a missing wallet on the street, your rational being says that you should keep it if nobody is watching and you will not have any kind of punishment; but your moral being could say that it is wrong to keep what is not yours and, although the gains with no costs you would have in keeping the wallet, the right thing to do is to find the wallet's owner.

Until now we have a neoclassical theory – defined by its method, substitution at the margin – more realistically built, while now it is possible to accommodate institutions, firms, time, and bounded rationality in the set of problems considered within neoclassical research program. In Lakatosian terms, we could say that Coase and North proposals aim to enlarge the protective belt of neoclassical research program. So, it is not a surprise the emphasis that North gives to the restrictive role of institutions as the rules of the game of the economic system.

Conclusion

In the first section, some debates in philosophy of science were presented to highlight the distinction concerning the aim of theoretical construction in Economics. Truth was considered the distinctive point between realism and instrumentalism; for realism truth is important in theoretical construction and for instrumentalism truth is not obtainable. Of course, we may have a conception of absolute truth as not achievable in science, but at the same time support the search for truth discourses about reality as a legitimate aim of scientific work.

Both American Institutionalists, like Veblen, and New Institutionalists, like Coase and North, can be said to be comprised with realism. However, those authors have different conceptions about realism and theoretical construction. While Veblen is not committed to a set of methods, Coase and North are concerned about being part of a tradition of thought in Economics, the neoclassical research program. So, to be within the neoclassical protective belt, Coase and North claim the use of specific methods – substitution at the margin –, committed to specific social categories – principle of rationality – and a definition of Economics' subject matter – choice under restriction in

an economic world made of scarce resources. In this social ontology, Economics is no more than a theory of choice, where social and/or economic relations have no place. In this world, people do not establish social relations, they interact instead. The place left for institutions in this world is that of only one more restriction to the maximizing behavior of the rational individual. Institutions also mold the world view of individuals in ideology, but just to provide internalized restrictions to individual choice.

A different theoretical orientation can be found in Veblen's ideas. Veblen intended to demonstrate how instincts developed through time until they are turned into institutions, or habits of thought, that orient and shape people's behavior. Sometimes, institutions may be more important in guiding behavior than instincts. Veblen also shows how the workmanship instinct emerges and is connected, in barbarism, to a positive evaluation of fight, being demonstrated by hunting and war activities. Therefore, demonstration of belonging to a (leisure) class, through emulation, becomes an end in itself. What was previously positively evaluated by society by its practical character – hunting and war – soon became positively evaluated just in virtue of being a behavior of the leisure class. Conspicuous leisure and conspicuous consumption are the forms of emulation and demonstrating belonging to the leisure class. Therefore, one can use consumption only for emulation purposes, despite the inadequacy of some goods for the person's needs. In the same way, a scientist may be more worried about being considered a scientist by his peers than engaged in a construction of more objective, ontologically oriented, social theories. Here we get to a distinction within realisms suggested by Veblen and new institutionalists.

Coase and North contribute to Economics with institutions and transaction costs, where this contribution is made within the limits of the neoclassical research program. In doing so, the authors are trying to bring more realism to Economics. Although their contributions are important and valuable, they are not open to an ontological questioning about the nature of Economics' subject matter. The problem is that in doing so, the subject matter of science is neglected, which critical realism called an epistemic fallacy⁹. Other problem is the denial of a theoretical pluralism, that is evident in the disqualification of American Institutionalism contribution, mainly the Veblenian ideas. New institutionalists usually qualify Veblen's ideas as anti-theoretical or outside the scope of economic science. Then, in new institutionalists' perspective, realism means only more realistic assumptions made under a specific theoretical construction, which critical realism called deductivism¹⁰. If this method is supposed to be scientific, to be a realist without ceasing to be considered a scientist, one had to limit the apprehension of social categories to what the mainstream theoretical construction allows to be known. In this sense, if this theory cannot handle complex social relations, then Economics must be committed with interactions and correlations between variables. To adopt this scientific orientation in order to be labeled as an economist is what can be called a conspicuous science behavior. Of course, an epistemic fallacy is implied in this conspicuous science.

The problem is not to be engaged with neoclassical theory. The problem is to embrace neoclassical theory because one think that it is the only scientific approach in Economics. If one thinks that neoclassical theory is the better way to understand and describe reality because it is the most objective theory, there is no problem. The question

⁹ Epistemic fallacy "consists in the view that statements about being can always be reduced to, or analysed solely in terms of, statements about knowledge, that matters of ontology can always be translated into epistemological terms." (Lawson, 1997, p.33)

¹⁰ "By deductivism I simply mean the collection of theories (of science, explanation, scientific progress, and so forth) that is erected upon the event regularity conception of laws in conjunction with the just noted principle of theory assessment." (Lawson, 1997, p.17)

becomes complicated when to use neoclassical methods is mandatory for one to be considered an economist and the researcher needs to use neoclassical theories to be recognized as scientist. That is what I called conspicuous science, to adopt a method not because it is the more adequate to understand the subject matter of a science, but because it is the one that will provide you the scientist status.

Veblen could be wrong in many of his claims, but it seems that his proposals were ontologically oriented in the sense I am suggesting here. Like all scientists he had some theoretical roots, but he dared to think outside the economic box. Maybe he was closer to the constantly critical behavior that Popper thought to be the right scientific behavior. However, we should be careful in considering Veblen's critique to orthodox Economics. His writings covers a period since the last decade of the nineteenth century and the first three decades of the twentieth century. What was neoclassical economics at that time? It was not the same neoclassical economics that North was trying to contribute with. At Veblen's time, economic science was living the reflections of the marginalist revolution and Economics as we know today in economic textbooks was still gaining form. We had to wait until the 1930's to the proposition of the most widespread definition of Economics, suggested by Lionel Robbins in his "Essay on the Nature and Significance of Economic Science", published in 1932. Then we waited until 1948, where Paul Samuelson and William Nordhaus published the first economic textbook entitled "Economics".

Therefore, Veblen was not a voice against the same neoclassical research program that new institutionalists, in some sense, helped to construct and that we know today through economic textbooks. Veblen was a critique of a set of theories that, in his conception, were not adequate to handle economics' subject matter. In this sense, I think Veblen committed to an ontological orientation. When he had to choose between contributing to a new science in the mold of marginalist revolution or to propose another approach to this new science, he took the last path. The motive that led him to take this path was an ontological orientation. Maybe the early supporters of Marginalism had also an ontological orientation, but the research program that emerged from this movement was more concerned in building a science than doing science.

Here we must say a few words about North's proposal. I really think that he attaches his theoretical contribution to neoclassical theory because he thought it was the only way of doing science in Economics. Despite this adherence, the author has not formalized mathematically his theory of institutions, he let this work for other economists. Although North made a great contribution to economic science, he failed when he rejected the equally great contributions of Thorstein Veblen, simply because Veblen's theories were not in pace with the neoclassical methodology. If in the process of knowledge, the object of study is the ultimate reference and the goal, the question is not what fits my model, but how can I theoretically apprehend this object within the theory (in thought). The last one is an ontological question, the first a scientific behavior that I called conspicuous science – when the researcher is more worried to have the status of scientist than to do science itself.

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