

INSTITUTIONS AT THE CROSSING OF CULTURE AND ECONOMY (A DRAFT)

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I. Introduction

In what sense is the study of institutions an interdisciplinary field? Is it because studies of legal, political, economic etc. institutions are localised within respective disciplines and call for some generalising, or integrative effort? Or, is it rather because none of existing social sciences is equipped to deal with institutions as a separate social phenomenon? This paper departs from the second hypothesis.

Particular social sciences dissect reality into legal, political, economic and other social structures, in which institutions are referred to according to the functions assigned to them in these structures. They are usually treated as stable entities which internal logic and dynamics is kept out of focus. The economists, e.g., are used to conceive institutions as externally given constraints bounding economic behaviour. They are ready to take into account transaction costs involved, but not social mechanisms making respective institution viable.

As a result, there emerged certain cognitive frames useful to deal with stable patterns of reality, but inadequate for the research aiming to indicate and assess new phenomena and development trends. The emerging knowledge-based society might serve as an example of such failure.

II. Kinds of knowledge in economics

There is a hypothesis (Martens, 2004) that economics is not so much about scarcity of material resources, as about scarcity of human cognitive capacity. Indeed, recent decades demonstrated growing attention economists devoted to knowledge and information.

However, economists' view of knowledge is rather limited. Economist is used to deal primarily with individual knowledge as a property of economic agents. Such knowledge can be divided into the knowledge of individual preferences and that of local opportunities. The latter is often assumed – for the sake of simplicity – to be perfect or near perfect ('perfect foresight' or 'rational expectations' hypothesis) thus making the knowledge assumption a part of general *ceteris paribus* clause, i.e. something left out of focus. The situation started to change with the emergence of the economics of information (Akerlof, 1970; Stiglitz, 2002, etc.) showing that the knowledge of local business opportunities heavily depends on institutional environment of human action and is plagued with numerous information asymmetries and imperfections.

As for the knowledge of individual preferences, the assumption that nobody knows them better, than agents themselves seems less vulnerable, even despite recent debates around the 'nudge' policies that reminded of its limitations. However, the relevance of this assumption depends on the principle of consumer sovereignty which is not neutral to the institutional set-

up. In a traditional society, e.g., preferences are shaped primarily by custom, and could hardly be interpreted as individual, even less – as sovereign. But even in the modern societies the stability of individual preferences – also an important assumption of standard economics – are based on cultural identities. Economists tend to overlook this non-individual residual of individual preferences leaving themselves unaware of the limits of their reasoning.

Since Schumpeter's "*Theory of economic development*" (1934/1911) and – especially – after the emergence of neo-Schumpeterian evolutionary theory (Nelson and Winter, 1982) economics recognised the relevance also of knowledge embodied in innovations. Unlike individual knowledge of preferences and local knowledge of business opportunities this kind of knowledge is universal in a sense that it is about the nature of things, and not about agents' views and conditions.

However, Schumpeter's theory differentiated between new knowledge as such (inventions) and innovations as a process of its introduction into the circular flow of inputs and outputs, and was focused entirely on the latter, so that the content of respective knowledge once again remained beyond the scope of inquiry. Within this framework innovations are treated as a kind of traded goods producing temporary profits, i.e. subject to the usual rules of market games. In this case limitations of economic reasoning involved even in the standard analysis of market adjustments become much more serious: innovations with potential impact upon long-term trends of economic development and cultural change are assessed through the lens of current consumer preferences. Inadequateness of such assessments is due to several reasons, such as different time horizons of consumer decisions and long-term trends, indirect connections between them, as well as due to the Galbraithian argument that consumer preferences are in fact imposed by the producers and social environment.

At less abstract analytical levels responses to the challenge of such inadequateness did appear. On the supply-side of innovation process the new research area of the economics of knowledge (Foray, 2004; Arena etc., 2012) has clarified specific features of knowledge production. On the demand side, the economics of creative, or cultural industries (Potts, 2011; Hesmondhalgh, 2007) shed some light on the conditions under which innovations are being perceived and accepted by the public. The common lesson is that on both sides simple reliance on market forces does not work, and certain additional institutional arrangements are needed.

III. Dual nature of institutions

Institutions are commonly defined as collections of formal and informal rules, combined with certain enforcement arrangements. Attention is usually centred on rules, i.e. on institutions as an *inter-subjective* reality internalized by the people as their beliefs underlying routine reactions under standard circumstances. Such rules are located in many human minds and manifest themselves in human behaviour – decisions and actions. These sets of rules are conceived as exogenously given; they might be recognized to have some impact upon economic

processes, but not to be a component part of economic reality. They belong to culture, not to economy¹.

Yet institutions are not merely an *inter-subjective* knowledge, but are a real-world phenomenon as well: the information contained in cultural codes is stored, processed and used by the real-world agents enforcing respective patterns of behaviour and updating them to changing environment. As an *objective* facet of institutions these rule-shaping functions are provided by organizations endowed with resources and powers necessary and sufficient to encourage and punish, to persuade and force.

Thus institutions are knowledge-processing devices with dual ontological status, both cultural and economic. Along with inter-subjective existence, they do exist as real-world entities – agents and organisations – which monitor, protect and enforce patterns of behaviour, translate relevant knowledge to new cohorts of agents, evaluate and update it in face of changing environment. Rule-shaping activities involve, among others, lawyers, scientists, teachers, civil servants, opinion-makers, image-makers, and comprise a growing part of contemporary economies.

IV. Cultural codes as knowledge

The kind of knowledge involved in rule-shaping activities is quite different from either knowledge represented in individual preferences and opportunities, and from universal knowledge generated by science and applied in technological innovations. It is stored as social memory and translated to the new cohorts of the population through cultural channels. Social norms and practices are assimilated within families and local communities, absorbed from life and art experiences, imitated after exemplary persons and cinema heroes, mastered in schools and universities. Being internalised these norms and practices serve as key components of personal and group identities of social actors, and hence the determinant of their basic attitudes towards labour, consumption and creativity.

For centuries persistence of these norms and practices was based on custom, i.e. institutions of traditional society. In the middle of XX century Schumpeter (1994/1943) lamented that entrepreneurial capitalism was most successful when political power was still in the hands of aristocracy. Writing about ‘crumbling walls’ conditioning capitalist development he focused on bourgeois mentality: *“Within a protecting framework not made of bourgeois material, the bourgeoisie may be successful... But without protection by some non-bourgeois group, the bourgeoisie is politically helpless and unable not only to lead its nation but even to take care of its particular class interest”* (Schumpeter, 1994, p. 138).

Thus Schumpeter differentiated between two domains of human activity: the business domain favouring entrepreneurship, and the public domain maintaining political and social ‘walls’ around the former. But he did neither describe, nor explain the content and mechanisms of the

¹ One might disagree with the latter point referring to formal rules which do not necessarily belong to culture. But formal rules lacking cultural roots are usually sterile or distorted institutions; at best they are unstable and crucially dependent on enforcement, i.e. they are not institutions *per se*.

latter domain. The concept of 'cultural code' seems to be helpful to elucidate some problems raised by Schumpeter's thesis. Public domain in this sense is supporting institutional framework of economic activity. In other terms, it is responsible for intergenerational transmission of basic social norms, or cultural codes.

Symbiosis of aristocratic governance and bourgeois entrepreneurship in several European societies appeared to be successful due to lucky combination of relatively stable rules in some spheres (law, polity, family) and flexible norms in others (consumption patterns, businesses etc.). But the balance between the two domains was far from stable. Too rigorous control over cultural codes could restrict creativity on the producer's side, and responsiveness to new ideas, on the side of consumers; while excessive flexibility of cultural codes could endanger cultural identity of population and threaten the social order.

Historically, the mixed market economies somewhat softened the contradictions indicated by Schumpeter. There emerged, e.g., intermediate governance structures to control transmission of knowledge embodied in cultural codes, such as professional corporations of lawyers or scientists. These corporations were organized in a way that provided them with both market and government shelters (Freidson, 1994), defending its members from profit-making imperative, on the one hand, and from dictates of political expediency, on the other.

While the very principle of corporate organization goes back to, at least, middle age crafts, the asymmetric economic structure with dominant market sector and small supplementary professional corporate sector was the outcome of capitalist development. In mature market economies this model took its shape at the end of the XIX century or at the beginning of the XX [Brint, 1994, p.30-38]. However, by the middle of the XX century this model came under strong pressure. Long-term trends of growth of state bureaucracy, of relative shares of such sectors as education, healthcare, and science lead to considerable widening of the professional corporate segment of economy at the expense of market sectors with corresponding intensification of redistributive processes. Neoconservative wave of late XX century has emerged as a reaction to these trends. It opened way to neo-liberal reform strategy imposing market regulation on the spheres with long tradition of professional corporate self-regulation. Process of broad marketization involved education, healthcare, and even many of government services. This strategy was based on belief in efficiency of market regulators independently of where they are to be applied. As a result, the role of professional corporations as guardians of cultural codes appeared to be underestimated. Recent research of professional communities has shown that erosion of the professional corporate component of basic social institutions caused some negative trends. Professional knowledge is being replaced with expert knowledge based on short-term criteria of efficiency and responsibility [Brint, 1994, p.15-17]; level of professional ethics tends to decrease [Ibid, p. 125].

V. Conclusion

Economy is conceived alternatively as interacting agents, or material circular flow, or an institutional set-up. Neither of these approaches provides a reliable framework to deal with

modern – *knowledge-based* – economy in which the crucial role belongs to knowledge flows. The element lacking in either of these economic ontologies are cultural codes, i.e. the knowledge embedded in institutions.

Historically most of rule-shaping activities – unlike prevailing rule-implementing ones – were organised as professions, i.e. as relatively independent corporations, shielded from direct influence from both market forces and political authorities. Under such governing structure professional corporations could serve as guardians of institutional stability and continuity. In the XX century professional corporations played similar role to that of Schumpeter's 'pre-capitalistic framework'. Marketization trends of recent decades tend to undermine this pattern. These trends have a common denominator. They are manifestations of a general trend to simplification of the structure of economic activity, weakening its strategic elements responsible for institutional stability and cultural continuity.

Economic theory tend to abstract from 'extraneous' elements. They did not fit into the 'right' picture of economic reality, even if such approach stimulates stepping on the same rake again and again. It is time to take into account the economic existence of a special realm of human activities which generate, translate, interpret, implement, protect and enforce programs of human action, or rules, or cultural codes in a broad sense. Culture is not just memory retrieved from libraries and museums, but even libraries and museums are real-world entities involved into a circular flow of current economic life. The same is true of judicial and political organisations, scientific and educational institutions, etc. This perspective has important ontological implications either, requiring, e.g., the reinterpretation of institutions as entities of dual nature. They appear to be both inter-subjective notions (rules, norms, cultural codes) existing in the heads of economic agents, and specific (real-world) organisations translating respective notions into agents' heads, and enforcing their persistent vitality. Thus, unlike mainstream view of economy as a homogeneous market space, it appears to consist of two unequal parts: one in which agents act according to their cultural codes, another – in which other agents make and guard these codes. Historical account of relationships between the two parts suggests that usually their functioning mechanisms were different. Market is a typical option for the main part of economy; a self-governed professional corporation – for the specific 'economy of cultural codes' part, with possible intermediate cases as well.

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