



Research Article

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Approaches to Economic Institutionalism: A Theoretical Review of its Characteristics and Elements of Study

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Abstract

Institutionalism emerges as a scientific construct of economics and sociology, becoming a fundamental element for achieving the development objectives of countries (Portes, 2009). The theoretical review of its approaches, characteristics and elements of study, based on the prominent works of Ronald Coase (1988), Douglas North (1990), Oliver Williamson (1988) and Elinor Ostrom (2009), are carried out with the objective of exposing from another perspective the theories of the Traditional Institutional approach (TI), the Economic Neo- Institutionalism (NE) and the New Institutional Economics (NEI). Through the description and exploration, qualitative and transversal, of primary and secondary sources, the convergent and differentiating elements of each approach are described, as well as the importance of their characteristics in the economic system. The study of Institutionalism allows the recognition of market failures, irrationality in the decisions of economic agents, agency problems in the implementation of public policies, the existence of transaction costs, taking as a reference the theories of Economic Institutionalism and its approaches.

Keywords: Institutionalism, Neo-Institutionalism Economic, New Institutional Economics

1. Introduction

The study of the currents of economic thought brings us closer to a better understanding of the theories, laws, models, assumptions on which several researchers have developed various studies with the aim of responding to the main problems of economic science. Some of these currents and their studies have managed to give Economics the category of science, others have achieved scientific recognition due to their notoriety in praxis.

Institutionalist theories have evolved and are the result of relationships and influences from different schools of economic thought such as: the Classical School, German Historicism, the Austrian School, Marxism. The question "Why do institutions arise?" raises a number of questions. The field of study of Economic Institutionalism addresses the complex relations of the economy with

institutions, from an approach that conventional economic science has discarded, and does not recognize their importance in the scientific world (Portes, 2006).

Based on these theoretical approaches to institutionalism, its study has regained importance in the scientific, political, economic, and social world. The main postulates derive from the studies conducted by the Nobel Prize winners in Economics: Ronald Coase (1988), Douglas North (1990), Oliver Williamson (1988) and Elinor Ostrom (2009), authors who established the theories of the Traditional Institutional (TI) approach, the Neo-Economic Institutionalism (NE) and the New Institutional Economics (NEI). When studying the theories of institutionalism, the complexity of this discipline is evident, which is why an exposition is made addressing these three approaches that are born from a holistic principle and is formed from a set of heterogeneous thoughts.

In the case of Latin America and other developing latitudes, formal institutionalism has been copied from other realities, without considering how institutions have developed as a function of the construction of knowledge of societies, resulting in economic blunders and crises, agency problems, transactional costs, which are not considered in the generation of public policies (North, 1993) (Williamson, 1998).

In analyzing the three approaches to institutionalism, elements that converge transversally in their approaches are discussed, as well as elements that characterize and differentiate their approaches. Ronald Coase in his analysis of the *Theory of the Firm* makes an interesting questioning and recognizes the antagonism between the real world and the neoclassical theory. The author states that economic phenomena take place between institutions (Coase, 2000).

2. Methodology

The qualitative cross-sectional study of the approaches of Institutionalism, its elements and characteristics, is carried out through the description and exploration of primary and secondary sources of the theoretical postulates of Ronald Coase (1988), Douglas North (1993), Oliver Williamson (1988) and Elinor Ostrom (2009), authors who establish the theories of the Traditional Institutional approach (TI), the Neo-Economic Institutionalism (NE) and the New Institutional Economics (NEI) respectively. With the documentary review of their main works and the discipline studies of this current of economic thought, the convergent and differentiating elements of each approach are described, as well as the importance of their characteristics in the economic system.

3. Results

Next, Traditional Institutionalism (TI), Neo-Economic Institutionalism (NE) and New Institutional Economics (NEI) are studied based on the exposition of three authors: Thorstein Veblen (1899), Douglas North (1993) and Oliver Williamson (1998).

All three authors recognize the importance of institutions in economics. Each of them differentiates their approach of study under this same current. Based on the description of these three perspectives, an attempt will be made to situate the evolution of *Institutionalism* and its elements of study in a well-founded manner.

3.1 Traditional Institutionalism (TI)

It arose in the United States at the end of the 19th century and based on its studies the role of institutions in economic activity was analyzed. Its main exponents were Commons (1931), Wesley Mitchell (1935) and Clarence E. Ayre (1987). Ayre (1987); however, the work of (Veblen, 1899) gives a comprehensive approach to the study of economics from various disciplines, in an environment of constant evolution. He relates institutions to instincts, habits, customs, and norms in economic performance. He recognizes institutions as the main component for allocating resources and regulating the actions of individuals in the market. From this perspective, *instincts* have a direct

influence on habits and an indirect influence on institutions.

From the incorporation and its logic on *instincts*, he exposes the institutions as the set of predominant practices around the relationship between the individual and the community, at a certain moment in the development of society. He exposes the dichotomy of social classes: *idle* and *working*. The *idle* social class has an institutional or ceremonial behavior, it is constituted by rulers, clergymen, military, and intellectuals; the conservation of the established order to maintain their *status quo* within the community, their behavior is based on inherited customs and practices. The *working* social class, has a technological or instrumental behavior, denominated as working, productive, technical class. The behavior of change creates patterns, and they have the capacity to adapt to new conditions, contributing to the solution of concrete problems. The relationship between ceremonial and instrumental behavior constitutes the driving force of institutional change (Veblen, 2009).

Evidently, the author exposes institutions and their relationship with biological evolutionism. His reasoning links the constant natural evolution of institutions and the adaptation to a changing environment, modifying the rigidity of ceremonial behavior through instrumental behavior (Veblen, 2009). Economic development is assumed as a process of ceremonial- instrumental dichotomy, in which habits intervene, builds its perception of reality and the intention to improve conditions through transformations, resulting in the generation of technology and innovation.

Starting with the Neoclassical theories after the Great Depression of 1929, *Traditional Institutionalism* was considered less rigorous than the mathematical models and theories developed (Gandlgruber, 2010) warns that the schools of economic thought in opposition to the approaches of institutionalism do not validate their empirical and superficial theories regarding human behavior.

The main contribution of this approach (Veblen, 1899) is the incorporation of institutions into economic analysis, subsequently studied by other authors who complement this scientific category, such as Douglas North (1993).

The absence of a general theory has been the questioning of this current of economic thought, considered idealistic. However, its importance is remarkable as it provides a new area of research in search of answers to economic questions that demand a new analysis (Gandlgruber, 2010).

3.2 Economic Neo-institutionalism (NE)

Douglas C. North, began his research at the University of Washington in Seattle, worked at the National Bureau of Economic Research, and was a professor at the University of Washington in Saint Louis. He argues that institutional changes are more relevant than technological changes in explaining economic development. His main work is *Structure and Change in Economic History*, North (1981). He received the Nobel Prize in Economic Sciences on December 9, 1993.

His works revolve around the study of the nature of institutions and their consequences on economic performance. He proposes the *Theory of incremental Institutional Change that affects the choice established at a given time*. The individual is the most important agent in an evolving institutionality, possessing limited rationality, incomplete information and interpreting reality from his experiences, all this under conditions characterized by uncertainty (North, 1993).

In stating these assumptions, he defines institutions as "Rules of the game in a society or, more formally, they are the humanly devised constraints that shape human interaction" (North,

1993, p13). Their primary function is to reduce uncertainty through a structure that guides human interaction. Structures define and limit the set of choices of individuals. When referring to *limits*, he defines them as *rules* that prohibit and condition human interaction. There are two types of limits: *formal* and *informal*. The *formal* ones are written norms of legal nature, such as constitutions, laws, resolutions, norms, rules, ordinances, among others; the *informal* ones integrate unwritten agreements and codes of conduct that are accepted by society and complement the *formal* ones.

Institutions can be created by the state or evolved over time. To explain institutional change and economic performance, North (1993) differentiates between institutions and organizations or

agencies. *Institutions* are rules of the game that define the way in which the game is played with defined objectives and strategies; hence their relationship with game theory.

On the other hand, organizations or bodies are groups of *individuals linked by some common identity towards certain objectives*, they are those that provide structure to human interaction, instances in which individuals relate and organize themselves into groups to undertake cooperative actions and act as *collective actors according to the rules contained in the institutions*. They can be organizations, *political* (political parties, the senate), economic (companies, unions, and cooperatives), *social* (churches, clubs), *educational* (schools and universities). Organizations are institutions because they are governed by rules that allow their governance (Ayala, 1999). The creation of organizations depends on the opportunities offered by the institutional context; thus "if the institutional framework rewards piracy, then pirate organizations will be born; and if the institutional framework rewards productive activities, organizations -companies- committed to such *activities* will emerge" (North, 1994, p.572).

The interaction between institutions and organizations gives rise to institutional change, where institutions are the rules of the game; individuals and organizations are the players. Institutional change defines a complex, extended, continuous and cumulative process that is a consequence, in turn, of individual decisions (North, 1993).

Institutional change is complex and manifests itself in the transformation of formal and informal norms. Its transformation is gradual, depends on perception and learning. The inclusion of learning allows studying decision making under uncertainty, mental change depends on genetics, own and others' experiences, time, the configuration of belief systems, cultural inheritance (Cairney, 2019) (North, 1993). Thus, institutional change *showing how societies evolve over time* is also the key to understanding historical change.

Economic development is a function of institutional change, collective learning, and incentive systems. With respect to the performance of the economy, institutions influence the costs of production change, which, together with the technology used, determine the transaction and transformation costs that constitute total costs. Incentives are the elementary determinants of economic behavior, and institutions define that incentive system (Cairney, 2019). Economic development depends largely on the institutional framework, giving way to cooperative solutions that arise from its protagonists, and not to the adoption of successful models from other environments, which when implemented their institutions reject, resulting in historical failures such as that of Latin America. (North, 1993).

Douglas North (1993) incorporates interesting elements, such as the difference between *formal* and *informal* institutions, the clarification of the concepts of institutions and organizations, the importance of cognitive processes and the interaction between actors and institutional change, as channeling agents of economic development.

North's (1993) institutionalist approach to development addresses cognitive processes and describes the importance of studying institutionalism. The economic history of Latin America is a history full of conflicts and mistakes; not considering these studies would be one more of those mistakes; individuals, companies, the State, cannot be a "copy and paste" of formulas developed in other institutional contexts; all these elements are described in the Traditional Institutionalism of North (Veblen, 2009) as well as the Economic Neo-Institutionalism of Douglas North (1993), and later in the New Institutional Economics of Williamson (1989, 1991, 1993); are the results of research processes inspired by concrete realities.

Although the *Institutionalists* have not formulated a general theory, they are a *theory under construction* according to North (1993). Neoclassical formulas with all the theories, mathematical and econometric models, positive policies, regulations, and other elements, have not solved the main economic questions raised by them; perhaps the option is to ask new questions about new phenomena, with new processes, new dimensions taking the approach of Schumpeter (1935).

3.2.1 Elements of Economic Neo-Institutionalism (NE)

For the description of the theoretical approach, the methodology proposed by the following is used Ayala (1999) and the elements of economic neo-institutionalism, based on the studies of Douglas North (1993).

a. Institutions

With North's (1990) analysis of the conceptualization of institutions, he refers to the degree of complexity integrating society, economy, and politics. "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 (North, 1990, p.3).

Ayala (1999), after analyzing several positions and the evolution of the term *institutions*, integrates in his thinking aspects such as learning, culture, values, within a system of rules that organize interaction.

Finally, Knight (1992) analyzes *social institutions* and exposes the link between society and institutions in the solution of problems and the generation of incentives that go beyond the strictly economic, which he identifies in relation to *economic development*. (Knight, 1992).

b. Types of Institutions

Within the analysis of the NE, two types of institutions are distinguished, according to their degree of legal formalization. Hence, institutions can be *formal* and *informal* North (1993).

[**Formal** are the rules written in laws and regulations, and are constructs expressly created by individuals to address specific problems of economic, social and political coordination. The application and enforcement of these institutions is mandatory and coercive power is required to enforce them. These institutions relate to the public domain.

[...] **Informal**, on the other hand, are the unwritten rules, which accumulate over time and are recorded in customs and practices. [...]. These are the result of the evolution of codes of conduct, values, ideas and traditions of societies. Ayala (1999: p. 66

The classification of institutions is influenced by two factors. The first one associates *formal* institutions with the State, which acts as the institutional direction; *informal* institutions are those that evolve over time and recognize social compliance; the latter are related to *customary law* (North, 1993). In addition to this reference, there is another classification, according to their origin; they can be social and state. The social ones are of voluntary creation and do not need to be regulated for their execution; their non-compliance entails informal self-imposed sanctions, they are called *conventions*. On the other hand, the state ones are executed by imposition of the State, their sanctions are stipulated in laws.

c. Economic Exchange

The reasoning of E. Phelps (1986) is mentioned in relation to institutions, exchange, and cooperation. Indeed, individuals who develop in a society obtain advantages from the exchanges they carry out, including the satisfaction of their needs, which will be of different kinds. It is institutions that make this interaction possible, reducing uncertainty by means of laws, rules and other mechanisms that guide the actions of those involved. The problem that arises from the exchange has allowed the inclusion in this current of Game Theory; and the interaction is described as a cooperative game, in which the participants obtain benefits (Phelps, 1986).

For the NE, it is fundamental that the dynamics of *Economic Exchange* be accompanied by complete information, property rights, contracts, regulations, public policies. Factors that are framed in Institutionalism, these aspects are opposed to Neoclassical reasoning, see Figure 1.

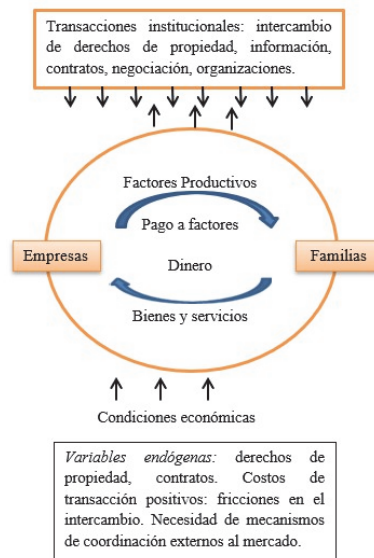


Figure 1: Neo-institutionalist Economic Exchange Model

Note: Comparison of the Neoclassical and NE model. Modified from the scheme proposed by Ayala (1999, p.100).

In accordance with these approaches, *opportunity costs*, which are better known as *transaction costs*, are incorporated into North (1993) analysis. For neoclassical thinking, without institutions there are no transaction costs, because the invisible hand regulates everything, information is free, cooperation is unnecessary and regulation by the state is redundant, since the market regulates everything. Contrary to this analysis, the NE frames all the interaction of economic agents within institutions, this interaction generates transaction costs. (North, 1993).

d. Elections and Conduct

In the positive analysis of economics, *homo-economicus* is associated with three characteristics: perfect rationality, maximizing behavior and selfishness. On the other hand, and in contrast, the NE exposes its dissatisfaction with these postulates, and demands a more in-depth analysis, due to two aspects. Firstly, the motives for choice are subjective (wealth, power, altruism, among others), and secondly, it does not possess all the information necessary to make a choice (North, 1993) (Greenwald & Stiglitz, 1986).

In order to approach this reasoning more logically, Ayala (1999) proposes incorporating considerations such as: learning derived from experience, identifying opportunities based on new knowledge, the circumstance that in the failure of their choices individuals deviate from economic efficiency, within the framework of a changing system.

e. Information

Information within the economy, with the development of ICT's, has generated what is known as the *information economy*; the development of networks, internet, connectivity, the exchange of information in real time, the collaborative economy that merges these aspects, have generated transformations in the markets. Studies within this category require information that complements this analysis on the role of information and its effect on exchange, organizations, markets and agents. For the NE analysis of information, it follows that: "The economics of information is based on the assumption that the process of production, acquisition and processing of information is costly, because markets do not

provide it adequately" Ayala (1999:139).

This leads to the *problem* of information, since there is incomplete and asymmetric information, which conditions the actions and decisions of the agents, generating various problems that can manifest themselves in the form of: *adverse selection* when one of the parties has an information advantage before reaching an agreement on the terms of the exchange; *risk aversion* in the restriction that arises from the lack of information, in this situation prefer not to act; *moral hazard* that can lead to opportunistic behavior between the agent and principal. For the NE analysis, information is a *crucial variable* in institutional performance; information is a tradable commodity that conditions decisions, and the State has a field of action from this perspective, as an entity that articulates information efficiently.

f. Transaction costs

Transaction costs specify what is being exchanged and validate the ensuing agreements. They consist of the resources required to measure both the legal and physical attributes being exchanged, the costs of monitoring and enforcing the agreement. The transaction costs of the transfer are partly market costs, fees and partly the cost of the time that each party must devote to gathering information. (Salgado, 2003).

In Caballero's (2011) analysis, he presents a hypothetical world in which transaction costs are zero, where the rights session would reach a socially optimal solution through transactions, and the reward system would be optimal, the rights would end up with those who really value them.

But this world without transaction costs does not exist in practice; in fact, the analysis from which the study of exchange of the neoclassical current is extracted, works for developed economies, supposedly of perfect competition, but the current economic crises reveal a theoretical vacuum, which does not fully satisfy the answers to the phenomena that occur with repetition. (Williamson, 1993).

To understand the interaction within the NE, the analysis of the basic assumptions of the NE is taken from Ayala (1999, p.101):

1. General equilibrium is exceptional, and there are no equilibrium prices, there are constantly mismatches between supply and demand.
2. There are market failures: monopolies, externalities, public goods, incomplete markets, adverse selection and moral hazard.
3. Incomplete, asymmetric and imperfect information.d) Positive transaction costs.
4. Institutions are endogenous variables.
5. Resource allocation requires institutional coordination mechanisms. There are not always Pareto optimums, the second best is chosen.
6. Discrepancy between individual choices and social welfare.

g. Property Rights

Property rights are the most relevant institutions in the allocation and use of resources in a society according to Williamson (1993), property in the form of assets enables exchange, production and trade.

Property makes it possible to harmonize the processes that take place between economic agents in the search for the satisfaction of needs; however, in addition to its advantages, the formalization of property rights also entails social conflicts. The role of the State is directly related to the legal system, which guarantees the enforcement, modification, creation and extinction of these property rights. (Vargas, 2008).

Within the NE approach, property rights create a formal system of incentives for economic activities such as incentives for investment, savings, labor, innovation, among others. In addition, property rights seek to balance market failures.

Property rights are strategic institutions in the allocation of resources, given the peculiarities involved in their formal and informal legitimization, and the incentive structure that

articulates the development and performance of economic agents. Ownership can be of different kinds, and in practice they can be: non-ownership, communal ownership, private ownership, social ownership, public ownership and state ownership. A capitalist economy, with positive transaction costs, demands an efficient performance of the State, which will be the active subject of property rights. (Schofield & Caballero, 2011).

h. Contract

With a different approach to Neoclassical economics, the analysis of contracts from the NE perspective studies the functionality of contracts and their evolution over time. For D. North, contracts arise with the intention of minimizing transaction costs and maximizing benefits. This author describes the functionality of contracts through their relationship with the creation of incentives; the greater the incentives, the greater the probability of contracting for the beneficiaries. The contract, like the institutional framework, evolves, because there comes a time when it no longer satisfies the needs of the parties. This dissatisfaction is due to several factors, such as lack of information, changes in the economic behavior of the agents, which leads to problems such as adverse selection, risk aversion, moral damage, opportunistic behavior, etc. North (1993).

The contract, together with other institutional constraints such as property rights, are closely related. The rules of the game guarantee the participation of the agents, protect their interests and establish the conditions and rights of the exchanges; in the absence of these *rules of the game*, the development of anarchy and conflict of interests, and the problems described by the lack of information, could be propitiated. Ayala (1999)

In contrast, contracts reflect the emergence of potential power and coercion structures that are inevitably established to expand exchange, because agents have incentives and expectations that contracts allow for increased benefits from coordination and cooperation (p.257). A definition of contract from the NI approach is provided by Ayala (1999, p.246) when he states the following:

The contract is a relevant institution that can promote or block cooperation in exchange; it is a substantive institution through which it specifies what kind of property rights can be transferred, and on what terms. The contract creates incentives for agents to engage in all types of transactions. It must also reflect the gains and costs of cooperation between individuals or agents, which is not always easily achieved because there are different possibilities for establishing the contract to share costs and benefits.

In practice, as contracts have different characteristics, they can be classified according to their institutional nature, formal and informal. Formal contracts are those stipulated by law and of obligatory compliance; informal contracts will be valid due to their recognition of use, custom and self-imposed by the parties, without the need for public power. In another classification, contracts may be explicit, which are expressly stated, or implicit, which are implicitly implied.

Consequently, the more efficient the institutional environment, the less formal and coercive the contracts will be, in a hypothetical environment. Since contracts are rules and protection mechanisms for economic agents in the development of their activities, they will evolve to guarantee economic efficiency.

i. Organization

Organizations are born as an effect of institutional restrictions: technological, budgetary and preferences. They articulate the constitution of organizations as they restrict their capacity, nature, actions and scopes of action. Organizations as mechanisms of coordination and cooperation in exchange and production go far beyond the scopes that limit individual actions.

There is a direct relationship between transaction costs and organizations, since they articulate the choice of a particular organization. Within organizations, learning and knowledge are carried out through activities, depending on the supply of information as a

decisive factor in their harmonization. (Caballero, 2011) (Schofield & Caballero, 2015). Institutions organize the incentive structure and determine the opportunities available in a society. Organizations are created to take advantage of these opportunities: organizations are created that reflect the opportunities offered by the institutional matrix (North, 1993). Organisms provide a structure to human interaction; they are groups of individuals linked together by some common identity and oriented towards the achievement of certain objectives. These organizations can be political (political parties, the assembly); economic (companies, unions, cooperatives), social (churches, clubs) and educational (schools and universities). Williamson (1993, 1988) proposes the following types of organization: *Individual ownership, partnerships, closed corporation, open corporation, mutual financial, non-profit organizations.*

j. Legal System

The legal system, as shown in Figure 2, tries to minimize disagreements and lack of cooperation, which are costs to society. Another important aspect refers to the way in which the law can protect property rights, in this way the institutionality achieves greater support through the various mechanisms of a legal system, which looks after the interests of all those involved, the protection of their rights, and the establishment of obligations (Coase, 2000).

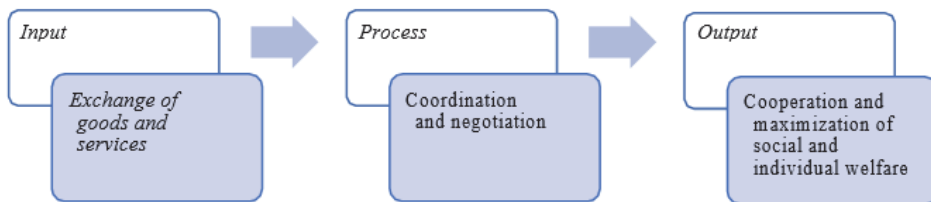


Figure 2: The legal system approach political model input and output.

Note: The legal system is the result of the negotiation of the interests of the interacting agents, on which the success of the policies implemented will depend, modified from Ayala (1999, p. 335).

As Ayala (1999) states, the legal system is the result of the negotiation of the interests of the interacting agents, on which the success of the policies implemented will depend, and the isolated conception of the legal system may hinder its application.

Based on Caballero's studies (2011, 2015), the main function of the legal system is to institutionalize laws that resolve conflicts arising from economic agents in the exchange of rights. The legal system guarantees institutional and social agreements, but demands laws, courts, judges, tribunals, lawyers that harmonize economic negotiations. The function of laws and institutions is to restrict and shape behavior, beyond the economic sphere, ensuring the maintenance of public order through the implementation of policies, according to the levels of action and objectives pursued.

k. Economic Performance

In recent years, the importance of the treatment of institutions and their relationship with economic performance has been fundamental. Starting with North's studies in 1993, factors such as the classification of institutions, the individual as a unit of analysis, rationality, learning, incentives and their relationship with economic performance have been analyzed. Undoubtedly, the recognition of the relationship between institutions and economic performance is one of the main contributions of NI thinkers in economic science. In this section we take the considerations of Douglas North, under the NI approach, which is

complemented by the research carried out by A. Portes (2006), in his article. *Institutions and development: a conceptual review*.

Based on North's studies (1993), when emphasizing the importance of institutions, North recognizes the level of complexity of his analysis, and that the concepts are still diffuse, given that economists do not have a complete vision according to the author, and it is necessary to give a holistic sense to the appraisals.

North (1993) analyzes how economies evolve and explains his reasoning on economic performance. He explains that neoclassical theories, despite five decades, have not solved the economic questions that analyze development. For North (1993) neoclassical theories are an *inadequate tool* for analyzing and prescribing policies that stimulate development. The erroneous assumptions on which his theories were based were that institutions do not matter, and in this sense also time.

Political and economic institutions are the fundamental determinants of economic performance North (1993), time is related to economic and social changes; hence its relationship with learning, which shapes the way institutions develop.

Ultimately, in North's scheme, the interaction between formal and informal institutions, rules of the game and organizations with their players will shape institutional evolution and change and, consequently, this will influence long-term economic performance.

Like most of the authors of the institutionalist current, his reflections revolve around the divorce between neoclassical analysis and institutionalism. For Portes (2006) "development is no longer conceived as a process of capital accumulation, but as a process of organizational change"

The typology of slow-moving and fast-moving institutions is recognized. "In his view, the reason for the failure of transplanted institutional blueprints to achieve their objectives in many Southern countries is that they clash with slow-moving institutions in the host country, such as social norms and entrenched power structures." Portes (2006, p.17). The approach is interesting, since the experiences of countries in Latin America, when adopting from constitutions, laws, organizations with success in other countries, have generated results that depend on the power of adaptation in formal and informal institutions recognized by North (1993) (Portes, 2009).

In the hands of development professionals, the new consensus has led to attempts to export legal codes and organizational blueprints in the countries of the South, uniformly and without nuance. The disastrous results of these attempts have already been recognized (Portes, 2006, p.18).

3.3 *The New Institutional Economics (NIE)*

The New Institutional Economics integrates, from its holistic sense, a set of contributions, which have evolved in this current of economic thought. (Caballero, 2011). There is a marked tendency to seek *the return of institutions* in economic science research. Its importance lies in three fundamental reasons: 1) it offers a different approach to that of neoclassical economics,

2) the market is no longer superlative to the elements of an economic system, 3) institutional change is the cross-cutting axis of the study of economic development (Schofield & Caballero, 2011).

Contributions to this category come from Coase's analysis (1988) and North, on transaction costs and institutions, respectively. In 1997, with the creation of the International Society for new Institutional Economic (ISNIE), chaired by both authors, a process of internationalization of this scientific category was carried out, extending to the five continents.

For Gonzalo Caballero, analysis of the NEI approach, takes another perspective of institutions, contrary to the traditional view of institutionalism, considers some aspects based on methodological individualism³ and moves from the mere description of institutions to a deeper analysis, maintaining a *hard core of neoclassical economics*, incorporating the model of information,

transaction and property rights costs. (Caballero, 2004) (Caballero, 2011) (Schofield & Caballero, 2015) (Schofield & Caballero, 2011) (Schofield & Caballero, 2017).

The NEI paradigm, which makes neoclassical reasoning more flexible, exposes bounded rationality as a function of the individual's cognitive development, preference stability and equilibrium.

Some components within the NEI will be discussed below.

a. The Individual

Possesses incomplete information, limited cognitive capacity, and rational choice is conditioned by subjective aspects. (Greenwald & Stiglitz, 1986).. As the NEI approach is the result of theories and studies that are opposed to the traditional analysis of economics, which, after centuries of evolution, are still studied and implemented in practice, with unsuccessful results. It is interesting to have a new panorama of analysis, considering the reasoning of this current, around the decision capacity, which comes from subjective mental models and cognitive processes. (North, 1993) the result of experiences with a structuralist tendency.

The importance given to the individual in the NEI, by not considering him as a passive subject whose behavior is determined by institutions, emphasizes the recognition of his subjective capacity to decide. Proving once again the apology of a category under construction, it is recognized its convergence features with modern disciplines, even sometimes not considered scientific, such as Social Economy, Neuro Linguistic Programming, and others that derive from the transformation of society, certainly in participation of an institutionalism.

b. Transaction costs and institutions

It is the economic expression of resources, to execute, preserve and exchange *property rights*. According to Williamson (1985) are the negotiation costs that allow the transaction in the economic system.

Zero transaction costs would be the *socially optimal costs*, where trade-offs would be truly effective, so that rights would be *where they are most valued*. All these eloquences describe a perfect market that in practice does not exist (Schofield & Caballero, 2011) (Caballero, 2011).

The conceptualization of institutions follows from the transaction costs; they are described as a *regularity of behavior* or a *rule that is generally accepted* by the members of a *social group* that directs behavior in certain situations, which will be of a formal nature or *external authority*, and formal or *self-imposed institutions* (North, 1993). Institutions are also in charge of designing an incentive structure in an economy, reducing the uncertainty that define and limit the executions of individuals and society, attributing to institutions the functioning of economies.

It is argued that contrary to the criteria developed by the Neoclassicists, it shows the omission of economic science when it does not take into account in its reasoning, the non-existence of perfect markets with zero transaction costs. The reality is the existence of market failures with transaction costs, which are influenced by problems of *asymmetric information or collective action (free rider)* (Coase, 1988) (Greenwald & Stiglitz, 1986).

After the analysis and incorporation of transaction costs and institutions, these two elements turn out to be the justification for the existence and functioning in the economy of the firm, the law and the political exercise. On the contrary, for the neoclassical current, according to the NEI analysis, there is no reason for the existence of the firm in an economy with a perfectly competitive market and zero transaction costs.

c. Contracts

Transactions involve *transaction costs* that determine economic activity and necessitate the enforcement of contracts. Contract making minimizes transaction costs and somehow provides the framework for bounded rationality and opportunism (Sent & Kroese, 2022).

Williamson (1998) proposes three contracting alternatives that address different

circumstances:

1) Classical contracting: approximates governance via the market due to the existence of a large number of buyers and sellers. 2) Neoclassical contracting: uses long-term contracts executed under conditions of uncertainty, applicable to occasional and non-standardized transactions. 3) Relational contracting: applicable to recurrent and non-standardized transactions.

The type of contracting depends on governance, which can take four forms: market, trilateral, bilateral and unified governance. From this approach Oliver Williamson relates economic activity to *vertical integration* and the market.

Economic development for this NEI approach assumes it with the efficiency of transaction cost savings affecting the behavior of economic agents. It does not conceptualize institutions or establish institutional change, but describes characteristics of their functioning (Crawford, 2023).

4. Conclusions

The study of *Institutionalism* allows the recognition of market failures, irrationality in the decisions of economic agents, agency problems in the implementation of public policies, the existence of transaction costs; taking as a reference the theories of Economic Institutionalism and its approaches. Regardless of the direction of the processes, there is a gap between formal and informal institutionality, given that imposed formality is often not complied with and unrecognized informality becomes customary; thus, only objectivity and the scientific study of these phenomena will allow the successful application of actions within a society that demands immediate solutions.

In Traditional Institutionalism and Neo-Economic Institutionalism, institutions are studied through a behavioral and multidisciplinary analysis, taking concepts from psychology and history to analyze the evolution of institutions and their performance. The New Institutional Economics approach introduces definitions from organization theory and contract law. The three approaches converge in criticizing the assumptions of the neoclassical current and its omission with respect to the study of institutions.

North (1993) makes a clear approach to the study of institutions and their classification into formal and informal. Formal institutions, relevant to this research, are those established through laws and regulations, their application and compliance is mandatory and requires formal recognition of power to enforce them, they are referred to the public domain, and their direction is in charge of the State.

The main discrepancy lies in the treatment given to institutional analysis; the IT approach studies instincts converted into habits capable of transforming the environment; North's (1993) NE approach focuses on the individual subject to formal and informal rules that shape his behavior over time and condition his economic performance; while the NEI approach concentrates on the transaction, its attributes and costs, as well as on the governance structures that govern economic activity, markets and firms. The absence of a general theory has been the questioning of this current of economic thought, considered idealistic, however, its importance is remarkable as it provides a new area of research in search of answers to economic questions.

This classification allowed the identification of the approach with which this research work was oriented, which by proposing the study of the institutional under the description of the elements that articulate the Economic Neo-institutionalism and are described in the work of Ayala (1999). Based on the definition and approach of these three authors and given that institutionalism constitutes a heterogeneous way of thinking, its treatment is complemented with works on institutions that give greater consistency to the proposed categories, the studies of Portes (2006) on economic performance were taken as an additional reference.

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