

# PROBLEMS OF DEFINITION AND THE THREE INSTITUTIONAL DIMENSIONS WITHIN INSTITUTIONAL ECONOMICS

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## Abstract

Some authors, like Geoffrey Hodgson, Tony Lawson and John Searle, have recently published papers in which they try to understand and define institutions. In Economics, the definition and the study of institutions are carried out within the scope of the Institutional Economics, but apparently there is no consensus concerning the definition of what is an institution within this school of thought. I claim that there is no insoluble conflict between institutionalists like Thorstein Veblen and Douglass North in which concerns the understanding of an institution, but I claim that these authors emphasize different dimensions of institutions. In the literature that stems from American institutionalism until the emergence of the new institutionalism we can observe three dimensions of institutions, namely, institutions as mental models, institutions as the rules of the game and institutions as organizations. As Malcolm Rutherford has pointed out in many articles, there is a discontinuity between the old institutional economics – the American Institutionalists – and the new institutional economics, but there are also similarities. In this way, we can observe some similarities between these two branches of institutionalist thought when we consider institutions in these three dimensions. Some authors will emphasize only one dimension, others will emphasize two or more dimensions; considering these dimensions together, instead of separating from one another, we can build a richer understanding of institutions. Considering how institutions structure human interaction – rules of the game –, how institutions mold human conceptions about reality – mental models – and how institutions act as big players or as teams – organizations – we have a more powerful theoretical construction to understand how institutions and human action build (together) the complexity of social relations.

**Keywords:** American Institutionalism, New Institutionalism, three institutional dimensions, institutions, human action

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## Introduction

Some papers, directly aimed to the understanding and definition of institutions, motivated this article, they are: Hodgson (2006), Searle (2005) and Lawson (2015). Institutional Economics is a school of thought in Economics, but apparently there is no consensual definition of what is an institution. Thus, the subject of this article is the way that the literature about institutional economics handle questions related to institutions and how it defines its object of study, namely, the institutions. Of course, to avoid polarized ideas that consider institutions as absolute restrictions, almost natural, to human action or as a mere voluntary product of human action, institutions must be considered in its constant and inextricable connection to human action. In fact, the theoretical distinction between institutions and human action does not eliminate the mutually dependent nature of these two elements of the social world. This mutual dependence was defined by Bhaskar (1998) as a relation that is symmetrically internal. Therefore, we can theoretically consider institutions and human action as separate categories of the social world, although they remain ontologically dependent on each other to exist and produce effects in the social world.

But why to talk about human action when considering institutions? One reason is that institutions does not exist without human action, and the other reason is that Douglass North and other new institutionalist authors emphasize matters concerning rationality and ways of individual action in their theoretical construction; even Veblen, an American Institutional, defined institutions as habits of thought, or ways of being and doing things. This is so because one of the major concerns of institutionalist thinking is how human action molds and transforms social reality through institutions. I do not intend to solve the question of what is an institution and/or what is social reality and the difference between institutions and social structures in this article, but I will try to point out some paths that could lead us to a better comprehension of these elements of the social world. Of course, this study has an important failing, that is, it does not deal with any concrete social object and to really know if a theory is good enough, or if it is objective, it is necessary to see if it helps us to understand real life situations.

I suggest that there is no insoluble conflict between institutionalists like Thorstein Veblen and Douglass North in which concerns the understanding of an institution, but I claim that these authors emphasize different dimensions of institutions and weave these dimensions differently in their worldview. In the literature that stems from the late nineteenth century American Institutionalists until the emergence of the new institutionalists it is possible to observe three dimensions of institutions, namely, institutions as mental models, institutions as the rules of the game and institutions as organizations. As Rutherford (1994) has pointed out, there is a discontinuity between the old institutional economics – the American Institutionalists – and the new institutional economics,

but there are also similarities. In agreement with Rutherford and others, I claim here that we can observe some similarities between these two schools of thought when we consider institutions in these three dimensions. Some authors will emphasize only one dimension, others will emphasize two or more dimensions, and putting them together, instead of separating from one another, we can build a richer understanding of institutions. Thus, considering how institutions structure human interaction – rules of the game –, how institutions mold human conceptions about reality – mental models – and how institutions act as big players or as teams – organizations – we have a more powerful theoretical construction to understand how institutions and human action builds the complexity of social relations.

This article is structured in three parts. The first one considers some of the founding fathers of institutional economics, where I specially work out some ideas of Thorstein Veblen, Wesley Mitchell, John Commons, Ronald Coase, Oliver Williamson and Douglass North. The aim of this section is to show how these seminal authors understood and defined institutions. In the second part some contemporary ideas about institutions are considered, specially the articles about the definition of institutions published by Hodgson (2006), Searle (2005) and Lawson (2015). In this section I intend to discuss the definitions of institutions proposed by Hodgson, Searle and Lawson in order to compare them with the idea of the three institutional dimensions as a way of understanding institutions. In the third part I suggest that the founding fathers of institutional economics focuses one or more of what I called the three dimensions of institutions, namely, rules of the game, mental models and organizations. In this section I drawn what I consider the most interesting ideas developed by each author to point out and highlight the commonalities between these authors of the old and the new institutionalist school.

## **I. The idea of institutions in the founding fathers of institutional economics**

Institutional economics is nowadays divided between the old institutional economics and the new institutional economics. The old institutional economics was a term coined by Oliver Williamson to differentiate the American Institutionalism arising from Thorstein Veblen's thought from institutionalists like Ronald Coase and Douglass North, which gave rise to the new institutional economics<sup>2</sup>. American Institutionalism, or old institutionalism, was a school of thought initiated by Veblen's article "Why is Economics not an Evolutionary Science?", published in 1898. His radical ideas called attention in American Academy in the interwar period, having as seminal authors Wesley Mitchell, John Commons and Clarence Ayres, in addition to Veblen himself<sup>3</sup>. Several facts may be

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<sup>2</sup> See Rutherford (1994), footnote 3, p.182.

<sup>3</sup> Rutherford (2001).

identified as causes of the American Institutionalism decline after the Second World War, like the abandonment of an instinct/habit approach by psychologists, the separation of sociology from economics, the rise of Keynesianism and the appearance of new institutionalism itself<sup>4</sup>. In 1937, Coase's article "The Nature of the Firm" gave impetus to this new branch of institutionalist thinking, namely, the new institutional economics. Coase developed the idea that the use of market mechanism has its costs, which he called transaction costs. Williamson developed further this idea in the context of the theory of the firm and North conjugated this idea with other concepts – like limited rationality, ideology, a theory of state and institutions – to build an institutionalist approach to economic history and economic growth. Of course, institutional economics is not limited to these two simple branches and those couple of authors, but what has been said is enough to give a quick overview of institutionalism in economics<sup>5</sup>.

In his seminal article "Why is Economics not an evolutionary science?", Veblen (1961 [1898], p.56) accused economics of being "behind the times", incurring in three misconceptions, namely, animism, taxonomy and hedonism. He defined an evolutionary science, therefore, a modern science, as a "close-knit body of theory. It is a theory of a process, of an unfolding sequence." (Veblen, 1961 [1898], p.58) Further, the author defines an evolutionary economics as "the theory of a process of cultural growth as determined by the economic interest, a theory of a cumulative sequence of economic institutions stated in terms of the process itself." (Veblen, 1961 [1898], p.77) By economic interest, Veblen (1961 [1898], p.76) meant the "material means of life", indicating the centrality of economic dimension on human life.

According to Veblen, Economics was not only teleological and excessively abstract, but also had a misleading conception of human nature based on hedonism, that is, an idea of man as a "lightning calculator of pleasures and pains" (Veblen, 1961 [1898], p.73). In this way, Veblen advocated not only a more empirical approach, but also an evolutionary approach based on another comprehension of human nature as moved by instincts<sup>6</sup>. These instincts will drive individuals for action and this action involves an interchange with material life, moreover the repeated action creates patterns that are crystallizing into habits of thought. Then, Veblen defines institutions as habits of thought:

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

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<sup>4</sup> Rutherford, 2001, p.183-184.

<sup>5</sup> For more about the history of institutionalist thought I point out to the reader the following work: Rutherford (1994, 2001), Hodgson (1994), Backhouse (1985), Furubotn and Richter (2005)

<sup>6</sup> Rutherford (1984); Backhouse (1985).

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)

So Veblen is suggesting that in carrying on the life process individuals develop habits of thought, or ways of thinking and doing 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 hedonistic way of action to an instinct based action. 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 individuals alone, he begins by modifying the behavioral conception of human action, likewise North's modification in the assumption of rationality.

Mitchell was not a radical critique of orthodoxy, making use of the theories he judged important to build his complex theories. Nevertheless, Mitchell agreed with the veblenian definition of institutions as habits of thought, arguing that orthodox conception of human nature was misleading. He understood institutions as "psychological entities – habits of thought and action prevailing among the communities under observation" (Mitchell, 1910a, p.112).

Social concepts are the core of social institutions. The latter are but prevalent habits of thought which have gained general acceptance as norms for guiding conduct. In this form the social concepts attain a certain prescriptive authority over the individual. Their daily use by all members of a social group unremittingly molds these individuals into common patterns without their knowledge, and occasionally interposes definite obstacles in the path of men who wish to act in original ways. (Mitchell, 1910b, p.203)

Although the comprehension of institutions as a habit of thought is based on the individual as a starting point, both Mitchell and Veblen seem to recognize what Hodgson (2003) denominated as a "reconstitutive downward causation". The patterns of behavior that may become rules are not absolute restrictions to human action, but they are temporally seem as constraining in the sense that

individuals cannot voluntarily and instantly alter crystallized habits of thought. It takes time and the result is not identical to what individuals had intended at first.

Commons is also considered a member of the American Institutionalism, but he has an alternative comprehension of institutions. The ideas of scarcity and transaction made him the most important American Institutionalism in new institutionalists' point of view (Furubotn; Richter, 2005, p.41). Commons (1931) takes the Humean idea that scarcity is the source of the conflict of interests and without restrictions to individual action those conflicts are going to be solved with the use of physical force. Those restrictions to individual action are provided by institutions, defined as the "collective action in control, liberation and expansion of individual action" (Commons, 1931, p.648).

Collective action ranges all the way from unorganized custom to the many organized going concerns, such as the family, the corporation, the trade association, the trade union, the reserve system, the state. The principle common to all of them is greater or less control, liberation and expansion of individual action by collective action. (Commons, 1931, p.649)

Institutions have working rules that are "expressed by the auxiliary verbs of what the individual can, cannot, must, must not, may or may not do" (Commons, 1931, p.650). Thus, working rules impose restrictions to human action in dispute for scarce resources, making institutions an instance of conflict resolution, or a mechanism of conflict resolution in this struggle for scarce resources. On this institutional mediated struggle, the idea of transaction is central, and Commons (1931, p.652) made the transaction the "ultimate unit of economic investigation". A transaction is an original agreement between individuals and is closely related to property rights, being defined as "the alienation and acquisition, between individuals, of the *rights* of property and liberty created by society, which must therefore be negotiated between the parties concerned before labor can produce, or consumers can consume, or commodities be physically exchanged" (Commons, 1931, p.652). Further, every transaction has three implicit social relations, namely, conflict, dependence and order; wherein what makes the order possible are the working rules established by institutions.

Before we turn our attention to the new institutionalists, we must note an important distinction between Commons and Veblen. In Veblen's conception, the conflict between individuals emerges because they have different habits of thought and, in Commons' conception, the conflict emerges because the economic environment is made of scarce resources and it engenders conflicts of interests between individuals struggling for these scarce resources. Furthermore, the association of a transaction with property rights and the idea of institutions as mechanisms of conflict resolution, a conflict that ultimately emerges from scarcity, makes his comprehension of institutions closer to new institutionalists like Coase, as we shall see, than to American Institutionalists like Veblen.

The seminal work in new institutional economics is Coase's article "The Nature of the Firm", published in 1937. In this article, Coase (1937, p.390) suggests "that there is a cost of using the price mechanism". Those "marketing costs", defined as "the cost of carrying out a transaction by means of an exchange on the open market" is also named as "transaction costs" in the literature (Coase, 1990, p.6). Transaction costs are all those costs involved in an economic transaction, like price survey, contracts and the knowledge of the market itself. The existence of positive transaction costs implies that the market is not the only mechanism of resource allocation, leaving to individuals the choice between competing mechanisms of resource allocation, namely, the market, the firm or the state (Coase, 1937; 1960). The author also identifies markets with institutions, "that exist to facilitate change, that is, they exist to reduce the cost of carrying out exchange transactions" (Coase, 1990, p.7). Therefore, it is possible to define an institution as a mechanism of resource allocation, where firms, markets and the state are all institutions.

Williamson (1985, p.15) also comprehends institutions as firms, markets and contractual relations, agreeing with Commons' suggestion of the transaction as the basic unit of analysis of economics and developing Coase's idea of transaction costs within the theory of the firm. The author also adopts Simon's idea of bounded rationality<sup>7</sup>, alongside with the idea of opportunism, defined as "a deep condition of self-interest seeking that contemplates guile" (Williamson, 1993, p.92). Bounded rationality does not imply that individuals are irrational; it means that individuals have computational limitations to process the information available in the economic world.

Bounded rationality is simply the idea that the choices people make are determined not only by some consistent overall goal and the properties of the external world, but also by the knowledge that decision makers do and don't have of the world, their ability or inability to evoke that knowledge when it is relevant, to work out the consequences of their actions, to conjure up possible courses of action, to cope with uncertainty (including uncertainty deriving from the possible responses of other actors), and to adjudicate among their many competing wants. Rationality is bounded because these abilities are severely limited. (Simon, 2000, p.25)

Therefore, in a world of imperfect information and individuals with limited computational capacity, institutions emerge as important economizing devices in the process of decision making. North also adopts the idea of bounded rationality and transaction costs, but he is concerned with matters concerned to the role of institutional matrix in economic growth. North defines institutions as follows:

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<sup>77</sup> Simon (1979; 2000).

Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). Throughout history, institutions have been devised by human beings to create order and reduce uncertainty in exchange. (North, 1991, p.97)

Therefore, institutions deliver a set of rules of the game where cognitively limited individuals can interact. North (1990, p.4) compares this institutional framework where human interactions takes place with the “rules of the game in a competitive team sport”. In the game of society, there are, likewise in soccer, a referee (the state), the players (economic agents) and the teams (organizations). The state has the function of guaranteeing the rules of the game, punishing those that do not comply with those rules. The state is at this position because it is “an organization with a comparative advantage in violence” (North, 1981, p.21). Note that, in North’s conception, the state is not an institution, but an organization, and institutions and organizations are different kinds of elements in the social world in North’s perspective<sup>8</sup>.

Another feature of North’s theory is the concept of ideology. North recognizes that sometimes individuals will not behave opportunistically, and it is not irrational. They do so, because sometimes individuals’ world view prevents them to act opportunistically, even if it is not rational do so.

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 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)

Thus, ideology refers to a self-policing set of conceptions that individuals possess about the world. In this sense, we can understand ideology as mental models. In a more recent book, North (2005) embraces the developments of cognitive science, considering more closely the idea of mental models. But as we can see, the idea of a cognitively apprehended reality already existed in North’s thinking through the concept of ideology. If we understand these mental models as selectively internalized rules of the game, once ideas cannot come from nowhere, and ideology as a mental model provides restrictions to human behavior, we can also understand ideology as a kind of institution. As Dequech (2002) has noted, a demarcation between the old and the new institutional economics has

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<sup>8</sup> In the correspondence exchanged between North and Hodgson, North makes his point clear, stating that he does not deny that an organization can be an institution, but for the sake of his research interests he was considering an organization as a player, in this specific case. The correspondence is available and is discussed in Hodgson (2006).



become increasingly difficult; one reason is that North's idea of mental models possibly approximated his theory from Veblen's idea of habits of thought, although these conceptions are not quite the same.

## **II. Defining institutions: some recent efforts**

Recently, some authors tried to explicitly and directly define what an institution is. We can mention at least three articles on this theme, they are: Searle (2005), Hodgson (2006) and Lawson (2015). In this section the ideas of these authors will be briefly exposed and then, in the next section, those ideas will be considered alongside with those of the institutional economics' seminal authors.

Searle (2005, p.2) takes a different way in approaching the definition of institutions. He suggests asking the question "what is an institutional fact" instead of directly asking the question of "what is an institution". The author proceeds to a series of definitions, from which we can highlight three notions necessary to explain social and institutional reality, they are: collective intentionality, the assignment of function and status function. Searle (2005, p.6) points out that intentionality is different from intending something and has to do with a directedness of the mind. So, if we unite intentionality with cooperative behavior we have the collective intentionality, which "is the basis of all society, human or animal" (Searle, 2005, p.6). Furthermore, the author states that what differentiates humans from other animals is our capacity to create institutional facts.

The assignment of function is when a function is imposed on an object, where this object does not have this function intrinsically, but only in virtue of this assignment of function (Searle, 2005, p.7). Searle gave the example of a tool, which would not have the function we gave to them if humans have ever existed. If we unite the collective intentionality to the assignment of function we will have a collective assignment of function. Then we end up with the formula "X counts as Y", that is the status function. The status function is a collective assignment of function to an object that gained generalized acceptance in the community. In this sense, we can only use pieces of paper representing money because people believe that those pieces of papers are money, or wealth. Now Searle is ready to define institutions and institutional facts as follows:

As a preliminary formulation, we can state our conclusions so far as follows: an institutional fact is any fact that has the logical structure X counts as Y in C, when the Y term assigns a status function and (with few exceptions) the status function carries a deontology. An institution is any system of constitutive rules of the form X counts as Y in C. Once an institution becomes established, it then

provides a structure within which one can create institutional facts. (Searle, 2005, p.10)

A rule can be understood as a regularized procedure of X counts as Y and institutions are made of rules of the form X counts as Y in C. These institutional rules, Searle says, are made of a specific kind of rule, the constitutive rules, that are different from the regulative rules. In the case of constitutive rules, the practices can only exist in virtue of the existence of the rule, like in games in general. In this sense, there are no soccer games without the constitutive rules of soccer. But in the case of regulative rules of the form "do X", practices can exist even when the rules are not present, as in the case of driving. So, people can drive even if traffic rules have never been created.

For Searle (2005), institutions do not exist merely to constrain behavior, but to create new sorts of power relationships, enabling and creating deontic power. Those deontic powers involve rights, duties, obligations, authorizations, permissions, empowerments, requirements, and certifications (Searle, 2005, p.10). Here Searle (2005) came to another formula: "we accept (S has power (S does A))", where this power can be negative (duties and obligations) or positive (right, power to do something). This can be understood as the social positions that people occupy in the social world. For example, if I am a professor I have the power to apply tests on my students, but I also have the duty of teaching them and preparing them for those tests. Briefly, for Searle, institutions are a special kind of social structure that are made of constitutive rules that has deontic powers and are collectively accepted, having the power to create institutional facts.

Hodgson (2006) has a comprehension of institutions very close to Searle's understanding, but Hodgson approaches the subject from a different perspective. The author tries to understand concepts like institutions, organizations, conventions, rules, norms, etc. in a dialogue with Douglass North in the attempt to clarify some definitions and build a consensual understanding of some core concepts of institutionalist thought.

As Searle, Hodgson (2006, p.2) understands institutions as a kind of social structures related to "systems of established and prevalent social rules that structure social interactions". Further, the author defines rule "as a socially transmitted and customary normative injunction on immanently normative disposition that in circumstances X do Y" (Hodgson, 2006, p.3). These social rules have a durability that enables ordered thought and action, molding the expectations of agents, imposing form and consistency on their activities (Hodgson, 2006, p.3). So, institutions are not only constraining devices, they also enable behavior. I think that it is a consensus that institutions are not merely constraints to human infinite bundle of choices, provided that human choice is impossible without an institutional framework. Therefore, we get to the conclusion that institutions structure, constrain and enable human behavior.

Now we should pay some attention to habits. Hodgson (2006, p.6) defines a habit as "an

acquired proclivity or capacity, which may or may not be actually expressed in current behavior”; in other words, a habit is not behavior itself, but “a *propensity* to behave in particular ways in a particular class of situations” (Hodgson, 2002, p.117). Repeated action and thought molds habits and when these habits gain some normative content they become a rule, potentially codifiable and prevalent among a group (Hodgson, 2006, p.6). This understanding of habits is very similar to Veblen’s concept of habits of thought. Here we can see that Hodgson’s concept of rule is very similar to Searle’s definition. In both authors a rule carries a normative content and depends upon collectively recognition. To synthesize, Hodgson (2006, p.7) defines institutions as “social structures that can involve reconstitutive downward causation, acting to some degree upon individual habits of thought and action”.

Another aspect that must be highlighted in Hodgson’s article is the concept of organization. The author presents a series of emails exchanged with North about some concepts as rules and organizations. North (1990) considers, for the sake of his theoretical interests, an organization as a player, not an institution, which does not mean that he does not acknowledge organizations as the church, corporations, the state, etc., as institutions; he states it clearly in the correspondence with Hodgson (2006). I agree with Hodgson in considering organizations as special institutions, provided they are also made of rules.

As we could notice, Searle and Hodgson address the question of “what is an institution” in different ways, but they converge in important concepts like rules and in the definition of institutions. Now we must consider Lawson’s contribution to this debate. The author suggests the investigation of the concept of institution as it was used in the old institutional economics, trying to build a conception of institution “coherent with our best account of social (philosophical) ontology” (Lawson, 2015, p.554). By social philosophical ontology, Lawson (2015, p.554) understands the “study into the basic nature and structure of social being”. In this sense, an institution can be understood as a social category.

For Lawson (2015), social reality is made of some characteristics: social systems as collectivities, structured social networks, constituted in part of social rules, interconnected, intrinsically dynamic (transformational model of social activity), emergence<sup>9</sup>. Social rules can be described by the injunction “if x do y under conditions z” (Lawson, 2015, p.555). This comprehension of rule is very similar to that provided by Searle (2005) and Hodgson (2006). Institutions are defined in one way or the other as social rules – the rules of the game, constitutive rules, etc. –, so there is some convergence in the definition of institutions as rules. The transformational conception of social being, that is, the “social structures being reproduced or transformed through human agency”

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<sup>9</sup> I will not get into details here. For more of Lawson’s conception of social reality see Lawson (1997, 2003).

(Lawson, 2015, p.557), highlights the idea of transformation and reproduction of social structures, leaving aside the idea of creation and determinism. If institutions are emergent social phenomena and a form of specific social structure (Lawson, 2015, p.558), then we can understand human action as capable of reproducing and/or transforming institutions, not simply creating institutions from plainly deliberative action.

Institutions are particular forms of emergent social phenomena, mostly social systems, or structured processes of interaction, that are either intended to be (whether or not they are), or are discovered a posteriori to be and are recognized as, relatively enduring. (Lawson, 2015, p.561)

Further, Lawson poses the question whether the term institution is a modern analytical category, answering affirmatively to this question giving three reasons:

1. there indeed exist *relatively enduring* emergent structures of social interaction (satisfying the condition of realism);
  2. there is no other term that captures the *relatively enduring* (and recognized as enduring) structures of society;
  3. these sorts of structure are sufficiently analytically important to warrant identifying in social realm.
- (Lawson, 2015, p.565)

Therefore, an institution is identified with relatively enduring features of social life that emerges from human interaction. It is important to notice that, compatible with the transformational model of social activity, the causality goes both ways, human interaction reproduces and/or transforms institutions and the social rules emanating from institutions enable and facilitates, in one word, structure human interaction. This is quite the same that Hodgson (2002, 2006) understands by a “reconstitutive downward causation”.

### **III. The three dimensions of institutions**

In this section I identify three ways in which the seminal authors of economic institutionalism define institutions, they are: (i) rules of the game, formal and informal; (ii) mental models; (iii) organizations. As we have seen, there is no agreement concerning the definition of institutions and the research interests of institutionalist authors were not the same. Here I intend to show that the

comprehension of institutions is not completely incompatible in the seminal authors, but can be complementary if we recognize that institutions have multiple dimensions. It is important to note that I am not saying that there are no ontological differences between old and new institutionalists, but we can, in the purely theoretical dimension and for suggesting an alternative perspective on institutions, consider the convergences rather than differences within the institutionalist debate. Let us begin by looking at the table 1, in which I placed only the seminal authors mentioned before.

**TABLE 1:** Institutional author and the three institutional dimensions

<b>INSTITUTIONALIST AUTHORS</b>	<b>THREE INSTITUTIONAL DIMENSIONS</b>		
	<b>Rules of the Game</b>	<b>Mental Models</b>	<b>Organizations</b>
<b>Thorstein Veblen</b>	cumulative sequence of economic institutions	human action is driven by instincts, crystallized in habits of thought	-
<b>Wesley Mitchell</b>	habits of thought imposes definite obstacles in the path of men	psychological entities, habits of thought	-
<b>John Commons</b>	has working rules, that tells what the individuals can, cannot, must, must not, may or may not do	-	going concerns as the family, the corporation, the trade association, the trade union, the reserve system, the state
<b>Ronald Coase</b>	mechanism of resource allocation	-	firms, markets, state
<b>Oliver Williamson</b>	contractual relations	-	firms, markets
<b>Douglass North</b>	rules of the game in a competitive team sport, humanly devised constraints	ideology, subjective perceptions people possess to explain the world	big players, a kind of institution

On table 1 we can observe some interesting things. First, all seminal authors understand that in some sense, institutions are made of rules, the rules of the game. As we pointed out above, the understanding of institutions as a system of rules is a point of convergence between Searle, Hodgson, and Lawson. When Veblen mentions the cumulative sequence of events, he is talking about crystallized habits of thought, or human practices that became habitual and are presented to people as a set of rules of conduct that must be followed. Of course, one can also do otherwise, this is the

basic condition for real human choice, for “if under conditions  $x$  an agent in fact chose to do  $y$ , it is the case that this same agent could really instead not do  $y$ ” (Lawson, 1997, p.30). The case here is not whether the agent is following or not the rules, but how a product of human action is presented to people as something exterior that coerces him. This is what is understood by the rules of the game, i.e., a set of modes of behavior – including restrictions and enabling features – that are engendered by humans but are presented to them as something external, natural, in some sense (apparently) immutable. We perceive institutional reality as immutable, where in fact it is not, because when we get into the world, the world itself already exists.

(...) most social institutions have been handed down to us already fashioned by previous generations; we have had no part in their shaping; consequently it is not by searching within ourselves that we can uncover the causes which have given rise to them. (Durkheim, 1982, p.37)

Men make their own history, but they do not make it as they please; they do not make it under self-selected circumstances, but under circumstances existing already, given and transmitted from the past. (Marx, 1852, s.p.)

Those excerpts from Durkheim and Marx are interesting in two senses. First, as Lawson (2015) has pointed out, individuals do not create institutions, they already exist when we start acting and thinking about them. There is no human action outside institutional world; there is no human action outside society. As Hodgson (2002, p.114) points out, an “institution-free state of nature is unattainable, in theory as well as reality”. And, at the same time, there is no society without humans acting within it, provided that social reality is “the domain of phenomena whose existence depends (non-contingently) at least in part on us” (Lawson, 2015, p.554). It does not mean that institutions, and social structures, are immutable, they can be transformed, as well as they can be reproduced. But, the institutional transformation cannot happen without boundaries. Paraphrasing Marx, Chang (2006, p.10) states that “it is humans that change institutions, albeit not in the institutional context of their own choosing”. Second, Durkheim makes a structuralist argument when he says that we cannot find what gave rise to social institutions looking within ourselves. In my point of view, there are two arguments here: (i) we cannot understand society from the individual level of analysis; (ii) we cannot explain society only using abstract reflections. This is precisely the claim for a holistic and realistic perspective on social science<sup>10</sup>.

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<sup>10</sup> I do not have the necessary space to extend on this subject here, but it is important to consider the critique to Durkheim structuralism addressed by Bhaskar (1998) in “Societies”.

The dimension of the rules of the game are evident in Mitchell's ideas when he says that social concepts, that are the core of social institutions, "attain a certain prescriptive authority over the individual" (Mitchell, 1910b, p.203). It is like Commons' idea of working rules, defined as "what individuals can, cannot, must, must not, may or may not do" (Commons, 1931, p.650). In these two conceptions, the idea of an institution as a rule of the game has some content of restriction and prescription. As Hodgson points out, a rule carries a normative content, and can be "understood as a socially transmitted and customary normative injunction or immanently normative disposition, that in circumstances X do Y" (Hodgson, 2006, p.3). Williamson's idea of an institution as a contractual relation, besides firms and markets, also carries a content of restriction and prescription, bounding the limits of human action. In some sense, restriction and prescription can be identified with what Searle (2005) and Hodgson (2006) are highlighting as the normative content of the rules. As we have seen, Searle went further and made a distinction between regulative and constitutive rules; but Hindriks and Guala (2015, p.476) argued that "identifying institutions with constitutive rules in contradistinction to regulative rules implies that Searle must deny that practices of etiquette are institutions". It seems that the concept of rule itself needs some refinement in the literature.

Hodgson also draws attention to the role of rules on the expectations of the agents, stating that "institutions enable ordered thought" (Hodgson, 2006, p.2). Rules molds individuals' expectations and play an important role in creating order and reducing "uncertainty in exchange" (North, 1991, p.97). According to Hodgson (2006), a rule is a repeated action and thought that becomes a habit with normative content. When a pattern of events is seen by individuals as something that will very probably happen, it gives to them some stability and predictability in their interactions and processes of decision making.

The cumulative process engendered by human practices in Veblen and the humanly devised constraints in North brings into light another dimension of the rules of the game, the constituted constitutive dimension of the rules of the game. In this sense, we can understand the rules of the game as something that is made by human actions and perceptions about the world (constituted) and at the same time molds individuals' way of thinking (constitutive), or mental models. It is close to what Bhaskar denominated as the duality of structure, that is, social structures are "both the ever-present *condition* (material cause) and the continually reproduced *outcome* of human agency" (Bhaskar, 1998, p.215). Veblen and North recognized the dimensions of the rules of the game and of the mental models in the institutional world.

Now it is important to distinguish the rules of the game from the mental models. In this distinction, the idea of a rule of the game as something external to individuals, although engendered by them, is fundamental. Mental models, as I understand here, are all the rules of the game internalized and processed by individuals that molds their world views. It is close to what North

understands by ideology, defined as “the subjective perceptions (models, theories) all people possess to explain the world around them” (North, 1990, p.23). Besides the concept of ideology North also considers a principle of rationality which accounts for individual behavior. North’s individual is an agent that acts inside an institutional framework, responding rationally, although bounded rationally, to the incentives provided by institutions, but can also act guided by ideology. Ideology, in this sense, can be said to be the internalized rules of the game. Therefore, ideological conceptions are inside the mind of individuals.

In Veblen’s concept of habit of thought there is a moment in which the rules can be said to live inside the mind of individuals, but at the same time these habits of thought have an external existence, outside the mind of individuals, working like a normative restriction, although temporary, to human behavior. When we create styles of dressing and submit ourselves to sometimes not comfortable clothes, the habits of thought (Veblen’s institutions) we create end up coercing us. In this sense, we build our own chains. But the weight of these chains can be differently perceived by individuals, and it depends on how our mental models adhere to the rules of the game. In Durkheim’s words:

Not only are these types of behaviour and thinking, external to the individual, but they are endowed with a compelling and coercive power by virtue of which, whether he wishes it or not, they impose themselves upon him. Undoubtedly when I conform to them of my own free will, this coercion is not felt or felt hardly at all, since it is unnecessary. Nonetheless it is intrinsically a characteristic of these facts; the proof of this is that it asserts itself as soon as I try to resist. (...)I am not forced to speak French with my compatriots, nor to use the legal currency, but it is impossible for me to do otherwise. If I tried to escape the necessity, my attempt would fail miserably. (Durkheim, 1982, p.51)

According to Durkheim (1982), institutions only are presented to us as restrictions when the rules they carry are not in accordance with what we think about the world or with our behavior. Although Durkheim may have exaggerated on this restrictive and coercive aspect of institutions, we can reasonably accept that most of institutions – that only exist in virtue of our beliefs and action – works as restrictions to our behavior, and it is interesting to look at some aspects of this restriction. Said in a more familiar way, how human action reproduce, by strictly obeying the rules, and how human action transforms, by eventually acting at odds with those rules. But it is not a matter of obeying or not the rules, provided that the institutions and human action are internally related, and, in the real world, it is not possible to separate them from each other. My point is that we can act according to the rules or not without being conscious, or even knowing, that we are doing so. It is not always a matter of deliberate choice to follow or not the rules.



That is how I think it is important to distinguish mental models from rules of the game. North's idea of ideology is rooted in individual perceptions and can be clearly distinguished from the rules of the game, while Veblen's conception of habits of thought attaches the idea of shared beliefs to social classes or groups, making the distinction between mental models and rules of the game more tenuous. In some sense, when we talk about mental models we are focusing on individuals, and when talking about the rules of the game we are focusing on social structures<sup>11</sup>. As we know, institutions are distinct from human action and mental models are a dimension of institutional world in the sense that mental models are internalized rules of the game, but they are not action itself. We can have shared mental models, but all rules of the game are shared in the sense that you would be said to be crazy if you do not believe them<sup>12</sup>.

Finally, it is important to state what is being understood by organizations. Hodgson (2006) argues that North did not separate organizations from institutions, but it depends on the sense that the idea of organization is being used – as a player or as an institution. Institutions are made of rules which carries, as Searle (2005) pointed out, deontic powers. Players act within and in virtue of the institutional framework. Those players can act intentionally or with some common purpose.

Individuals are purposeful, whereas institutions are not, at least in the same sense. Institutions have different lifespans from individuals, sometimes enduring the passing of the individuals they contain. Their mechanisms of reproduction and procreation are very different. (Hodgson, 2002, p.115)

Human beings act intentionally in the sense that our actions in the world are always ontologically oriented and in this cognitive apprehension of the world we transform the natural world according to our will and at the same time we transform ourselves and enable the emergence of a social world. Marx called this connection between men and nature as labor. Alongside with Lawson (2015) we can also consider social realm as being emergent from the organic material.

Labour is, in the first place, a process in which both man and Nature participate, and in which man of his own accord starts, regulates, and controls the material re-actions between himself and Nature. He opposes himself to Nature as one of her own forces, setting in motion arms and legs, head and hands, the natural forces of his body, in order to appropriate Nature's productions in a form adapted to his own wants. By thus acting on the external world and changing it, he at the same time changes his own

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<sup>11</sup> I am aware that I am making strong claims here and I leave a more detailed account of those issues for future articles. When I suggest that institutions has a dimension of rules outside human mind and another inside human mind, I think I am doing nothing more than to recognize this intrinsically connected nature of human actions and beliefs and social structures.

<sup>12</sup> A good example is money. If one believes that sand, instead of dollars, reais, euros, etc., is money, he or she would be said to be crazy and will not effectively realize its purposes in society.

nature. He develops his slumbering powers and compels them to act in obedience to his sway. (...) A spider conducts operations that resemble those of a weaver, and a bee puts to shame many an architect in the construction of her cells. But what distinguishes the worst architect from the best of bees is this, that the architect raises his structure in imagination before he erects it in reality. At the end of every labour-process, we get a result that already existed in the imagination of the labourer at its commencement. He not only effects a change of form in the material on which he works, but he also realises a purpose of his own that gives the law to his *modus operandi*, and to which he must subordinate his will. And this subordination is no mere momentary act. Besides the exertion of the bodily organs, the process demands that, during the whole operation, the workman's will be steadily in consonance with his purpose. (Marx, 1887, p.127)

I agree with Searle (2005, p.6) that intentionality is different from the ordinary sense in which people intend to do something<sup>13</sup>. I understand that human action involves intentionality in the sense that to be effective in the world our action must be oriented to the properties of being (ontologically oriented), which implies that we must have some idea, even if it is imprecise or not scientific, about the world. In this sense, if I want to go out on a rainy day (and get dry on my destiny) I need to do things that help me to accomplish my goal; if I despise the properties of water and decide to go out with a shirt of my soccer team hoping that it will protect me from the rain I will fail terribly on my purpose. To act ontologically oriented, it is needed to say, we must have at least temporary enduring social structures, as Bhaskar (1998) and Lawson (1997) has asserted. Now that we stated, although quickly, the main difference between individuals and their actions from social structures – of which institutions are a type –, we can turn to the consideration of organizations.

When a group of people merge together with a common purpose we can say that they are acting through an organization, which does not have in itself any intentionality in the sense humans have. In this sense, organizations and human beings can act in society as players, but they are ontologically distinct. Organizations, following Hodgson (2006, p.8), can be understood as a special kind of institution, with some features, they are: “(a) criteria to establish their boundaries and to distinguish their members from nonmembers, (b) principles of sovereignty concerning who is in charge, and (c) chains of command delineating responsibilities within the organization”. Thus, the state, religions, universities, teams, clubs, firms, unions are all institutions. This institutional dimension, as we can see on table 1, is found in Commons, Coase and Williamson. Although North does not deny that an organization is an institution, he is more interested in organizations as players<sup>14</sup>.

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<sup>13</sup> I agree with most of Searle arguments about institutions, but we take separate ways in which concerns the original institution, or what makes us different from other animals. I think Searle, and also Hodgson, puts an excessive emphasis on language. In this case, I think, with Lukács (1980), Engels (1876) and Marx (1887), that what makes us different from other animals is the category of labor. But it is a subject for another article.

<sup>14</sup> See Hodgson (2006).

Notice that to act as a player, the process of decision making within the organization must pass the evaluation of its members, and these members probably have distinct decision-making power and the organization itself has its own internal rules. Is it possible for an organization to have mental models? I do not think so, provided that mental models require information processing, learning, reasoning, that is, things that only human beings are capable of. However, within an organization we may have some shared mental models, or some alignment on people's conception about the world.

## **Conclusion**

The idea of the three institutional dimensions does not invalidate the definitions of institutions presented by the authors shown in the second section. This perspective on institutions permits us to look at them in all those institutional dimensions found in the institutional economics' seminal authors. I was not trying to precisely define institutions in this article, what I intended to do was to build a path for future research. Now I am going to summarize what has been discussed and indicate some issues that need further development.

I called institutional economics' seminal authors, those authors that are mostly recognized as giving the seminal contributions to this field of economics, namely, Thorstein Veblen, Wesley Mitchell, John Commons, Ronald Coase, Oliver Williamson and Douglass North. Of course, there are other important authors in institutional economics, like Clarence Ayres, John Kenneth Galbraith, Elinor Ostrom, amongst other, but I made a deliberate choice here and decided to concentrate on a few authors. Likewise, there are other attempts to define institutions, even in other fields of social science, but I chose some recent articles – Searle (2005), Hodgson (2006) and Lawson (2015) – that addressed explicitly this issue.

The purpose of working with the three institutional dimensions is twofold. First, it is important to recognize that seminal authors had not only distinct conceptions about institutions, but also they had different research interests, even within the same school of institutionalist thought. Amongst old institutionalists there were those who were concerned with theoretical issues, like Veblen, and others interested in more applied theories, like Mitchell with his business cycles and Commons' concerns about law and economics. Even between new institutionalists, there were Coase and Williamson, whose concerns were on the theory of the firm, and North, that was more interested in the role of institutions in the economic growth. Second, the three dimensions shows us that we can try to group institutionalists authors together on a richer understanding of institutional issues. Although there are methodological, and even ontological, differences between new and old institutionalists, it is possible to use insights of authors from both schools of thought.

On table 1 I did not classify Searle, Hodgson and Lawson within the three institutional dimensions. First, these author's articles were aimed at defining institutions, even though I have referred to other works I have not went deeper into their theoretical frameworks. I prefer to use their conceptions rather than classifying them. But if we look to their definitions of institutions it is possible to say that they do not explicitly deny any of the three dimensions of institutions. Perhaps the statement that "all mental reality is in the minds of individuals" (Searle, 2005, p.21), brings the author closer to the mental model dimension. The idea of a "reconstitutive downward causation" approximates the conceptions of Hodgson (2002, 2006) to Veblen's idea of habits of thought, which seems to merge the dimensions of mental models and rules of the game.

We may have the impression that the rules of the game (outside human mind) and the mental models (rules inside human mind) are sometimes merged concepts. In some sense, they are, mainly when we are on the domain of informal rules of the game. Our structure of thoughts also has rules, and those rules comes from somewhere, that is, the institutional world that exists outside our minds, although they could only exist in virtue of the existence of humans thinking and acting in the world. In social reality it is not possible to disentangle mental models from the rules of the game, provided that this distinction between the rules inside the mind and the rules outside the mind is a theoretical distinction for the purpose of conceptual apprehension of the world. This distinction can be sharper in some authors, like it is the case of North's distinction between the rules of the game on one side and ideology on the other, or this distinction can be a tenuous one, as it is in the case of Veblen's concept of habit of thought. I think it is precisely this connection between mental models and rules of the game that can provide a promising path to understand how human action reproduces and/or transforms institutional framework. To accomplish this task, the ontology suggested by Bhaskar (1998) and Lawson (1997) in the "transformational model of social activity" is very much promising.

Not only a clearer distinction between mental models and rules of the game are necessary, but also a closer look at the dimension of organizations. It is important to study the connection between human action and institutions considering that the way people act in society will depend of the dimensions of institutions at stake. It is on the dimension of mental models that most of new ideas and practices are engendered. Of course, powerful organizations have more favorable conditions to impose changes or even prevent them to occur. The organizational capacity is an important ability in the social world, being much stressed in the literature about social capital<sup>15</sup>. Organizations can act as players to modify the rules of the game, but its effectiveness will depend on its power. Likewise, the system of positions in society gives to some people more power to impose their purposes in the social

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<sup>15</sup> In the literature about social capital we have important names like Pierre Bourdieu, Robert Putnam and James Coleman, although they do not completely agree in which concerns the definition of social capital. About these divergences see Woolcock (2001).

world than to other people. The president and the state are more powerful in promoting economic development than the pope and the church, although the last still have an important role in delivering spiritual content to the mental models of many people. The quality of unions responds for the balance of force on wage negotiations. Wine traders in Brazil faces a commercial challenge in convincing Brazilians that drinking wine is as good as drinking beer, once in the mental models of most Brazilians the first choice is a beer, even when it is cold<sup>16</sup>.

Then, it is more common to reproduce than to transform an institution in all its dimensions. How human action, embedded on the social system of positions, has produced fundamental modifications in the ways people think and act, in the legislation, in the state itself, is a historical product that can be accessed only through a dip into history. I intended to show here some theoretical elements that could help and guide more historically applied works.

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<sup>16</sup> Of course, wine faces other obstacles, like high taxes, low income, and others.

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