AN INSTITUTIONALIST-CONVENTIONALIST APPROACH TO THE PROCESS OF ECONOMIC CHANGE

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Abstract: This paper highlights the problems that neoclassical theory encounters in providing a comprehensive explanation of the process of economic change. Whereas institutionalism combined with conventionalism has the merit of conceptualising economic and social processes, showing that institutions are the result of social interaction and not just structures produced by rational and maximising individuals. The Economics of Convention provides a theory of rules that is close to institutional foundations. Thus, an institutionalist-conventionalist approach will explain the interaction between individuals and institutions, shaping goals and desires, in a process of economic change due to institutional change.

Keywords: beliefs; economic change; institutional change; rationality, institutionalist-conventionalist; uncertainty

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Introduction

According to Veblen (1898), neoclassical economics is a taxonomic science, which focuses on static analysis; in fact, it is a good theory of distribution under certain conditions, but it cannot go beyond. The assumptions maintained by the neoclassical theory are essentially two: 1) a given institutional situation, founded on private property as a natural right; 2) the hedonistic calculus, that is conceiving economic agents as perfectly rational beings, capable of solving optimal problems, without any limit of a computational or informative nature. Thus, neoclassical theory is confined to the field of sufficient reason (Veblen, 1909).

The analysis of neoclassical theory is not suitable to provide a contribution to explain the process of economic change (Ostrom, Basurto, 2011). It is often criticised as being a static theory, a theory of general equilibrium, because, as Sylos Labini (2000, p. 77) states, real time is absent, the curves used represent hypothetical variations and the techniques are given. Therefore, the analysis of a development process is not allowed, since the idea of examining such a process by assuming shifts of these curves is not acceptable. However, the studies of Romer (1987), Lucas (1988) and Rebelo (1991), have allowed the introduction of dynamic elements in the static analysis that marks the theory of neoclassical growth. Thus, Sylos Labini (2000, p. 77) adds: 'Neoclassical theory is not rejected, but efforts are made to move from a static to a dynamic approach and make the forces driving growth endogenous'. But at the same time, he also states that the efforts made in this direction by these economists have not been successful (Sylos Labini, 2000, p. 78).

In summary, the central problem of neoclassical theory is to explain the conditions of optimal resource allocation and to identify the equilibrium points of the different phenomena analysed through static curves. The neoclassical approach may be useful for some short-term analyses, but it is not useful to address the problems of economic development (Sylos Labini 2000, p. 80).

It is certainly not a new criticism that traditional economic theory is based on static equilibrium models (Morselli, 2018a), which do not consider time in the sense of historical change and innovation[1]. Even the Austrian school, from von Mises to von Hayek, pointed out that the equations of economic equilibrium do not take time into account – since they unrealistically postulate the simultaneous interdependence of all variables. Moreover, it argued that this lack has resulted in the inability to adequately treat money, competition, market imperfection and the role of knowledge (Hayek, 1937-1952).

For example, North (1981-1994) began his work as a historian of economics with a neoclassical radicalism, sharing a view on efficiency[2] based on the maximising rationality of the individual (Zouboulakis, 2005). But subsequently, he changed course and continued with the discovery of the importance of institutions. Gradually moving away from the neoclassical tradition, he developed an original institutionalist theory in the nineties. The elements of neoclassical theory that North deems worthy of consideration are the postulates of rarity and competition, the idea of constrained choice and the influence of relative prices. Yet, North criticises neoclassical thinking because it disregards institutions and time, neglects transaction costs and relies on unlimited rationality[3]. Referring to Simon (1987), he highlights the limits that mark the

[1] Voegelin already wrote in 1925 that steady-state economy is a 'contradictio in adjecto'.

[2] Criticism concerning the efficiency of markets comes from Barberis and Thaler (2003), who show that asset prices also reflect the behaviour of not completely rational individuals.

[3] As Faundez (2016, pp. 385-386) states, although North has a very critical attitude towards neoclassical theory, he takes some of its principles into account, exposing himself to the same problems that this theory presents. But subsequently North's attitude is one of deviation from neoclassicists; in fact, he will give birth to the 'institutionalist theory', able to overcome some limitations of neoclassical thinking.

knowledge of individuals, as well as their ability to deal with the information they possess, and recalls in support of this argument the context of uncertainty in which, in most cases, economic and political decisions are taken. However, North shows a tendency to maintain the maximising trend, ignoring the argument that in making decisions, the individual aims at satisfaction rather than maximisation. In fact, for Simon, individuals do not seek to maximise goals, since it would require complete knowledge of alternatives and a great capacity to process the corresponding information, as well as the availability of plenty of time to process the choices. In actuality, in the pursuit of objectives, they are happy with a satisfactory, rather than maximising outcome, and end up examining the alternatives as soon as they have achieved them.

Therefore, we have to take into consideration the cognitive and computational bounds that hinder a complete application of rational calculation mechanisms (Simon 1982). In fact, within a complex and uncertain context, the agent has bounded cognitive capacities and is not able to achieve a goal of maximisation of his welfare function according to the postulates of substantial rationality of standard theory.

According to Zweynert (2009), with *Institutions, institutional change and economic performance*, North (1990) increasingly emphasises the importance of the belief structure, considering both ideologies and institutions classes of shared mental models. The individual learns to make his choice in very uncertain contexts with the help of a mental model, and then communication between individuals generates shared mental models, which lead to the creation of ideologies and institutions that evolve in parallel. North thinks that learning rules and computational processes are endogenous to the institutional structure. Most of the choices that are defined as rational are actually only partially the result of individual reflection, rather they derive from a thought formation process in the wider social and institutional context.

Hence the need to understand how, in different environments, the learning process and its consequences in terms of belief systems and institutions occurs. It is essential, then, to intensify studies in order to deepen the relations between human beings, beliefs and institutions.

We will try to understand what kind of theoretical structure is needed to understand the process of economic change. Starting from highlighting the limits of neoclassical theory and through an institutionalist-conventionalist analysis, it will be possible to develop hypotheses on change, which are able to improve the human environment and economic results.

Transformations and the uncertainty of human condition

In the Arrow-Debreu model (1954), prices concern all present and future economic goods. This hypothesis of a complete market system eliminates any uncertainty from the model and avoids having to take into account the anticipations of the agents who make their decisions once and for all in the initial instant. Even more so than the metaphorical auctioneer, in this model, information is free and immediate. Therefore,

the Arrow-Debreu model, putting aside the idea of natural long-term price as a centre of gravitation (which was given attention by the traditional marginalists, Jevons, Menger, Walras, Marshall), has focused on the concept of intertemporal equilibria.

As Nuti (2018) states, this vision is difficult to find in reality, since there is a lack of intertemporal markets for future goods (or futures), except for a small number of markets for homogeneous primary products and domestic and foreign currencies, and for narrow horizons. Secondly, there is a lack of contingent markets, i.e. goods associated with particular 'states of the world', which could eliminate risk, but not uncertainty [4].

Another problem found in the theory of general equilibrium concerns time. In fact, now, the theory admits the awareness of decision-makers (in the initial period) that equilibrium prices cannot be expected to remain unchanged over time. The possibility of price change poses itself as a problem since it influences decisions in the initial period. Therefore, intertemporal equilibria can only occur in the presence of complete futures markets, which already existed at the initial period, or following Radner's sequential equilibrium (1982), in which the hypothesis of perfect price forecast is introduced. It should be noted that neither complete futures markets nor perfect price forecasts are found in the real world. Perfect foresight assumes that individuals must predict the equilibrium prices that will prevail, which means requiring operators to have computational capacity beyond the realistic (Petri, 2017, pp. 9-10).

Radner admits that perfect foresight could be found only in contexts where relative prices do not change (are constant or almost constant), and thus, past prices are an efficient guide for future prices. This requires an endogenous composition of capital if we are to refer to a constant. In this case, complete future markets and perfect foresight are not an alternative hypothesis but equivalent. However, as Radner implicitly states, the sequential equilibrium proposed by him is altered when there is an arbitrary initial vectorial endowment. In this case, complete futures markets allow for the determination of equilibrium, but perfect foresight cannot occur (Petri, 2017, pp. 10-11; 2015).

This is a sign of the inability of the neoclassical theory to deal with a context marked by heterogeneous capital goods, as shown by Garegnani (1976). He reflects on the passage from a concept of capital as a single quantity, measured in value, to a vector of *n* physically specified goods and, at the same time, on the passage from a concept of equilibrium as a system of prices that can be interpreted as normal or long-term magnitudes to a sequence of equilibria referred to subsequent dates in time[5].

[4] According to Drèze's thought (1999, pp. 7-12), the most important development of the theory of general economic equilibrium concerns Hicks' (1936) temporary equilibrium, with a sequence of short-term equilibria and therefore does not often have efficiency properties.

[5] In order to construct temporal sequences of general equilibria, the non-persistent character of at least one of the determinants, i.e. the physical composition of the stock of capital goods, is highlighted. Assuming a capital stock in an arbitrary manner given in the types and quantities of the goods constituting it, at the initial date it will not be the most appropriate with respect to the other circumstances that the theory assumes as given, i.e. consumer preferences and available production methods. Already in his criticism of

However, another criticism of neoclassical theory stems from Keynesian thought (Skidelsky, 1998, p. 109), since Keynes states that the economy is built on a radical uncertainty, a possibility excluded from the neoclassical hypotheses of a defined and calculable future. Uncertainty is proper to the human condition, and not depending on us, we have to suffer it, looking for strategies for survival.

Why does uncertainty arise? According to Weber (1968), it arises from a spatial and temporal dissociation within society. The separation of these two vectors of human action on different levels, not connected to each other, dissolves the traditional reference coordinates of human action by precipitating the individual towards a feeling of absence of certainties, orienting him to rediscover new coordinates for each context. This breaking of space-time equilibria has a historical reason that goes back to the first industrial revolution, at the end of the 18th century, and to the evolution of progress reflected in the social and economic context. This operation of spatio-temporal upsetting begins with the separation of work activity from the domestic home, created by factory work, which will lead to the disjunction of producers from their means of subsistence. Thus the birth of profit and the simultaneous liberation of man's means of subsistence from the network of moral, family and neighbourhood ties is determined (Bauman, 2002, pp. 28-29).

In the presence of space-time dissociation, an important role is played by institutions, since they have a superior information equipment, compared to the individual. The increase in information on the characteristics of a specific activity has led to an improvement in forecasting capacity (Morselli, 2018b, pp. 514-517). For example, in the 15th century, the introduction of marine insurance, which concerned the collection and comparison of information about ships, their cargoes, destinations, journey times, shipwrecks and related compensation, allowed uncertainty to become a risk and was an important factor in the growth of European trade in the early modern age (North, 2006, pp. 37-38).

The change in the institutional framework, a key factor in reducing environmental uncertainties over time, implies changes in the structure of incentives. This is the main tool used by individuals to transform their own environment. Historically, institutional change has changed the benefits obtained from cooperative activities (e.g. the introduction of mandatory contracts), developed incentives for innovation (patent laws) and reduced transaction costs in the markets (introduction of laws to reduce contract enforcement costs) (Morselli, 2017).

Walras, Garegnani recorded that the period of a single production cycle would be sufficient to alter the physical composition of existing capital. All this must be taken into account in the construction of the theoretical system, which must be equipped with a sequential structure capable of accommodating subsequent endogenous modifications of the vector of capital goods, starting from an arbitrarily given stock, which constitutes the initial endowment of means of production. Thus, the theory is represented by a succession of general equilibria, each of which constitutes a system of prices and quantities referred to a specific date (Ciccone, 2012, p. 254).

The evolutionary science of institutionalism

Veblen (1898) analyses and highlights the link between the central role of institutions and the evolutionary approach, which considers the process of economic change. Society in general and the economy, in particular, are evolutionary sets of institutions, therefore, the evolutionary economic science that Veblen strives to construct is based on institutions, which are dominant mental habits[6] and actions within the social community. Institutions are marked by relative inertia with respect to social evolution, they are products of the past and are never fully in harmony with the needs of the present (Veblen, 1899).

The formation of institutions, or mental habits, is the result of a complex interaction between different levels and times of evolution. The most relevant level is that of instincts, or hereditary inclinations, which have been selected in the course of man's long biological and social history. According to Veblen, these instincts are divided into interdependent favourable inclinations, which work for the good of society, and problematic inclinations, also interdependent, which work against the interests of the group. The two sets of instincts influence or contaminate each other, depending on historical configurations (Chavance, 2010, p. 21).

The habitual elements of human life change continuously and cumulatively, generating a continuous diffusion of institutions. There are permanent changes in the institutional structure, prompted by changes in the discipline that occur in the context of changing cultural conditions, but the essential aspects of human nature remain unchanged (Veblen, 1914, p. 12).

Institutions represent an extension of habits, and the growth of culture is a cumulative sequence of habituation; the paths it follows and the means it uses represent the response of habits to the perpetual cumulative variation of needs (Veblen, 1909).

According to Veblen (1904), the economic system is not a self-regulating mechanism, but rather a cumulative unfolding process. Every economic institution is a complex of conventional habits, roles and behaviours, i.e. a type of theoretical relationship not based on the mechanistic concept of equilibrium.

The notion of cumulative causality occupies a central place in Veblen's evolutionary institutionalism. Firstly, it implies a sequential approach to change, marked by the irreversibility of time and the cumulative nature of successive transformations.

In contrast to the linear and deterministic concept of causality (cause → effect), Veblen speaks of recursive causality as a return of the effect on the cause (cause → effect → cause). This means that institutions constitute not only an object, but also a selection factor in the evolutionary process. When applied to the relationship between

[6] Mental habits derive from lifestyle habits. The discipline of everyday life has the effect of modifying or reinforcing the inherited institutions in the context of which human life takes place (Veblen, 1901).

the individual and the institution, this process leads Veblen to distinguish himself methodologically from methodological individualism. Institutions derive from individual actions, but they, in turn, condition them, so that any form of methodological reductionism, whether based on the individual or the institution alone, must be rejected (Chavance, 2010, pp. 25-26).

Psychological mechanisms must be taken into account when analysing individual behaviour, but these mechanisms include the interplay of institutions. Today's situation shapes tomorrow's institutions through a selective and coercive process, acting on men's habitual judgement of things and modifying a mental attitude handed down from the past. As Hodgson (2004) points out, in Veblen's view, the preferences of individuals are made endogenous by the impact of the evolutionary role of institutions, instead of being an external datum of individual action, unexplained and ultimately mysterious.

Thus, it is possible to observe complex processes in which changes in the social context and the formation of institutions evolve jointly and determine each other, resulting in an institutional dialectic.

Institutionalist economics between customs and habits

For Hamilton (1919), institutionalist economics is based on human behaviour, which emphasises the role played by impulses and instincts, rather than the rational, utilitarian individual of neoclassical economics.

Hamilton (1932), inspired by Veblen, claims that an institution is a set of social customs, designating a way of thinking or acting, which is embedded in the habits of a group or the customs of a people. Synonyms for institution are procedure, convention, order, customs; institutions set the limits of human activities and impose a form on them. Hamilton's examples of institutions include informal sets of customs and mores such as common law, higher education, literary criticism, athletics, the moral code (to the extent that each of these entities involves sanctions and imposes taboos), as well as some formal organisations such as government, church, university, business, trade union (which issue directives, impose sanctions and exercise authority over their members). He also considers institutions, the monetary economy, classical education, department store chains, religious fundamentalism, democracy, barter, burial, worship, diet, and the laborious life. Institutions tend to adapt to changes in culture and context: the life of an institution depends on its ability to adapt. But in the context of change, there are always elements of disorder. Similarly, the transposition of an institution into a different society necessarily entails its transformation: its core is freed from its cultural matrix and assimilated into the customs in whose context the institution is placed (Chavance, 2010, pp. 29-30).

Hamilton (1932) highlights the complex nature of institutions, which imposes its pattern of behaviour on human activities and its constraints on the outcomes of

unforeseen events. The institution represents at the same time a tool, a challenge and a risk: order and disorder, fulfilment, the unexpected and frustration are all in its path. In general, between institutions and human actions, complementary and antithetical, there is a constant, mutual reference in the never-ending story of the social process.

Centrality and ambiguity of institutions, which constitute factors of order and disorder, incorporating knowledge and ignorance, while being subject to historical drift, transformation and forgetting of their origins. This is the institutionalist thesis forcefully expounded by Hamilton (Chavance, 2010, p. 32).

Knight (1947) argues that the forces that help shape human society belong to an intermediate category between instinct and intelligence. They refer to custom, tradition and institutions. These laws are transmitted within society and acquired by the individual through a relatively spontaneous and even unconscious process of imitation. The fact that any adult individual conforms to them is a matter of habit.

Katona (1951) argues that habits play a central role in economic behaviour, both for the consumer and for entrepreneurial activities.

Both neoclassical and Austrian theories, on the contrary, fail to evaluate habits adequately. For example, Austrian economists consider all actions, habitual or not, as intentional. Neo-classicists claim that habits can be represented using a modified version of the traditional preference function. Thus, habits are considered to be rational actions that are repeated because the cost of changing them is thought to be too high; or they are seen as the outcome of a Darwinian process of natural selection by which it is ensured that all repeated acts tend to be optimal and, thus, rational only because the repeating agent has survived (Hodgson 1991, p. 179).

An important function of habits is that they enable us to cope with the complexity of everyday life, since we are able to maintain a pattern of behaviour without having to engage in rational calculations involving a large amount of complex information.

With reference to consumer behaviour, Keynes (1971) claims that an individual's income is intended to satisfy his or her habitual life.

In a survey on consumption, it was found that many households make most of their purchases without examination, without planning; what a consumer buys does not depend on a systematic search for information or different buying opportunities (Newman, Staelin, 1972; Houthakker, Taylor, 1966).

Customary behaviour and institutions

We have seen that neoclassical theory implies that economic behaviour is essentially non-habitual and is not carried out through customary practices. On the contrary, it is based on rational calculation and margin adjustment towards an optimum. On the other hand, the study of habits is important for economic science because it concerns the extended presence of customary behaviour throughout the economy.

For example, economic activity takes place in a context of customary law, which is not perceived through detailed knowledge of the laws, but through casual observation of its operation. In this way, agents are able to judge whether a contract is valid and assess the likely legal consequences of a set of acts. Members of a business community exist and act within a network of boundaries, often delimited by customary rules and agreements of a formal or informal nature. It is generally accepted that many labour markets are underpinned by a series of contractual rigidities and behaviours, many of which are marked by tradition and dominant social culture (Hodgson, 1991, p. 185).

As Veblen (1964) claims, much of a country's industrial capacity consists of a set of relevant habits, acquired over a long period of time, which are widespread in the available workforce and embedded in its practices. Nelson and Winter (1974; 1982) also think that the enterprise operates through habits and customary behaviour. They argue that habits take on the role of containers of knowledge and skills.

Customary practices do not only represent actions that have become stable, but also shape and enable future actions. Habits and customary practices can play a positive role because, given the amount and complexity of information involved, it is not possible to make a fully conscious decision for all actions. Therefore, for the individual agent, they have functional importance, as they reduce the amount of decision-making inherent in the complexity of everyday behaviour. This represents one aspect of the general cognitive and informational functions of social institutions and practices. An important function performed by institutional practices concerns the passage of information between economic agents (Hodgson, 1991, pp. 186-187).

Regulated and customary behaviour establishes a set of rules set by habit, convention, and tacit or law-based social conformity or acceptance. Such rules help agents to prefigure the potential actions of others (Kornai, 1982, p. 79).

Customary institutions and practices play a constructive role by developing information about the behaviour of other individuals. Thus, customary habits and practices created by some individuals make possible the conscious decision-making activity of other individuals. Even assuming that tastes and preferences are not subject to change, the informational function of institutions and customary practices will lead to certain lines of conduct, modified by the information the institutions themselves provide (Schotter, 1981).

The information created and distributed by institutions is social in nature and not purely subjective. It is produced by the customary behaviour of a group of individuals and becomes all the more significant, the more widespread and stable this behaviour is. Although the information developed may be perceived differently by each individual, it is based on the social institution. Consequently, by recognising the informational function of institutions, we move away from a purely subjectivistic perspective.

Institutional change and economic change

Veblen (1898) wrote that economics is a theory that considers a sequential process or development and sets itself objectives that are not immutable, based on cumulative causality.

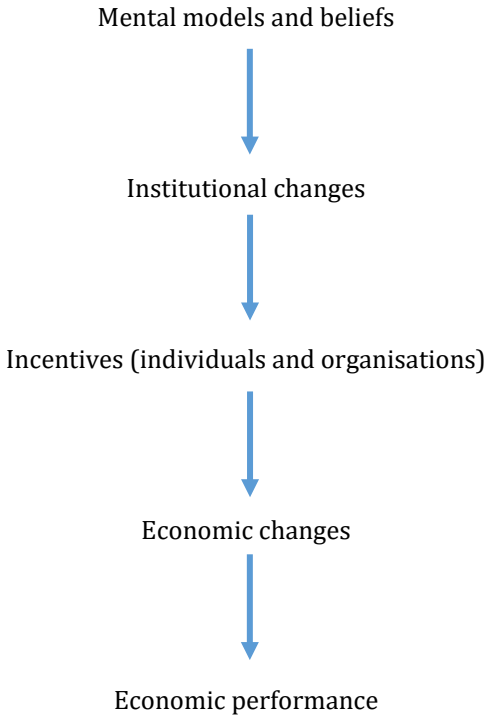
The economic activity of the individual turns out to be a cumulative process of adaptation of the means to purposes that change cumulatively as the process unfolds. Thus, both the agent and its environment are at all times the result of the last stage of the process. It can be said that institutional change is endogenous to the long-term economic movement. The central interest in the question of *change* in the study of economics is highlighted. Institutions can be imagined as an element of permanence in a changing world. For example, if we think of capitalism within an institutional configuration, historical originality is given by the continuous change it generates. But it is also true that even if institutions present themselves as perpetual, they are born, evolve and disappear. So, the institutional approach is faced with a relevant question, that is, the relationship between continuity and change. In particular, it is the different temporalities of institutional change and economic processes (the differential of change) that deserve attention. Consequently, the interest in the *processes*, in the temporal sequences of cumulative change is predominant with respect to the *equilibrium* approach, the central thought of the neoclassical tradition. The more one distances oneself from neoclassical thought, the more one is led to analyse processes.

According to Denzau and North (1994), institutional change is gradual and progressive, while radical changes, resulting from wars, revolutions and natural disasters, are rarer. Mental models and beliefs also tend, as a consequence, to evolve progressively, over long periods, followed by shorter episodes of fundamental changes.

The process of change may encounter problems during its course (causal sequence). First of all, the past institutional architecture may contain beliefs resistant to change, either because the proposed changes are at odds with the previous belief system, or because the changes presented threaten the power of the representatives of existing organisations. Secondly, the structure that defines economic performance includes the presence of interdependent institutions; thus, the modification of only one of them, in order to produce the desired performance, is insufficient and, in some cases, counterproductive. Economies with an unsatisfactory performance have an institutional matrix that does not provide incentives for activities aimed at improving production.

When agents' choices produce results that have not been foreseen, there is the possibility that they review their schemes of interpretation of reality, with a reciprocal adaptation that leads to a new provisional equilibrium.

In particular, the causal sequence of the process of change can be represented as follows:



As Aoki (2001, p. 4) states, understanding the process of institutional change can be similar to understanding the ways in which agents change their beliefs. Therefore, the relative uniformity of the analytical models, used to assess the distributive consequences of different institutional matrices, allows actors to eliminate alternative interpretations of the functioning of causal links, making it more likely that an agreement for the consensual construction of the rules of the game will be successful.

Rationality and institutionalism

In neoclassical theory, individualism is taken into account to explain social phenomena through rational and optimising behaviour guided by exogenously defined desires and goals. Therefore, in this context, human actions are governed by rational calculation and optimising behaviour is determined by a Darwinian mechanism of survival of the fittest. For example, for Friedman (1953, pp. 3-43), the pool player acts as if he knows the complex mathematical formulae from which to derive the optimal direction to impose on the ball. Thus, he argues that the evolutionary interpretation of the maximisation hypothesis must be based on a rationalist concept of action.

The neoclassical economist Pareto (2006 [1910]), in his book '*Non-logical actions*', defines non-logical action as behaviour in which the means are not logically related to

the ends. Non-logical conduct concerns human actions that are carried out instinctively and in accordance with custom; therefore, Pareto's rationalist concept of action is only valid for a limited set of behaviours. Whereas rationalists claim that every action can be explained by a single rational mechanism. For example, habits can be regarded as completely rational repeated acts; in fact, Downs (1957) claims that habitually voting for a party, despite being partly ignorant of its actions, is a rational conduct, because it would be expensive for citizens to obtain the information to reconsider their electoral behaviour. Becker (1976) claims that there are stable preferences behind the simultaneous actions that take place at all levels. At the same time, there are also sophisticated neoclassical models of human behaviour and decision-making processes that are positioned on more than one level, in the presence, however, of basic rationality, in order to incorporate some form of habitual action (Hodgson, 2004, pp. 149-160; Thaler, Shefrin, 1981; Winston, 1980).

We find the lack of an explicit differentiation between levels of consciousness in the model of decision-making activity and affirm the existence of a stable preference function. In both of the above cases, we find the objections of Hindess (1984), adding that the rational choice model does not consider relevant dynamic factors and treats agents as if they had a criterion for evaluating their own ends.

Veblen (1919, p. 239) rejects the optimising rationality hypothesis as unrealistic. Rationality is difficult to apply because of the limitations of the human brain and the lack of information. Individuals are not self-contained entities, but socially constructed beings. Human behaviour represents the interaction between instincts and institutions, defined as established habits that are common to the generality of individuals, which influence the perception of reality, leading to the formation of preferences. Moreover, for Veblen, institutions are systems of social rules that shape the interaction between individuals, constituting the cognitive infrastructure that selects the information necessary for human action. They are the heads of individuals and are at the origin of social structures; the constitutive material of institutions is a habit, which represents the product of repeated behaviour that ends up generating social rules.

From this analysis, an interaction between institutions and individuals emerges, i.e. institutions influence human actions and vice versa. The close relationship between the two entities represents a process of evolution and every change has a cause and an effect, as a model capable of interpreting changes in the economic and social structure. Thus, the interaction between human actions and institutions, together with the rejection of the hypothesis of optimising rationality, makes it possible to recognise the importance of institutions in processes of change.

As we will see in the next section, institutionalism combined with conventionalism has the merit of conceptualising economic and social processes, showing that institutions are a product of social interaction and not just structures created by rational and maximising agents whose objective is individual interests.

Conclusion: an institutionalist-conventionalist approach

The Economics of Convention develops a theory of rules that is close to institutional foundations[7]. An initial approach to the notion of convention is based on a subset of social rules, a particular type of rules marked by a certain arbitrariness and of obscure origin (Favereau, 1999). The convention school features an interpretative approach that emphasises the normative dimension of conventions, the importance of representations and the procedural nature of rationality (Batifoulier, Larquier, 2001, p. 22).

Conventions attempt to solve coordination problems, i.e. contexts in which it is convenient for each individual to follow a certain course of conduct, provided that the other members of the group do the same (Morselli, 2015). Conventions concern non-legislative rules of conduct, defined as impersonal norms, which are based on unorganised, informal, non-institutionalised sanctions (punishments or rewards). The existence of a conventional constraint produces incentives not to defect, i.e. each individual deciding on a strategy is unable to obtain a better result by changing his or her choice (Ullmann-Margalit, 1977, p. 97).

By pursuing their own ends, each individual helps to reduce uncertainty, because by adapting to informal constraints, they convey information about likely actions in their social environment (Young, 1993). Since they do not present costs of organisation or political control, conventions are preferred to a formal order that guarantees equal levels of certainty (Hayek, 1982).

According to Akerlof (1980), different forms of conventions correspond to multiple institutional equilibria. The existence of rule *X*, which prescribes conduct *A* and forbids conduct *B*, favours the coordination of expectations, since all the members of the group, knowing it, expect the others to do *A* and not *B*. The same result also occurs with rule *Y* which prescribes *B* and forbids *A*. Sometimes individuals can set their own intentions or expectations if everyone is aware that others are doing the same thing. Most institutions point to clues to coordinate behaviour, some determining point in each individual's expectations of what others expect him (individual) to do (Schelling, 1960, pp. 57-58; Liebowitz, Margolis, 1995).

The convention is understood as a type of coordination, alternative to the price mechanism, used as an instrument for coordinating human behaviour. In chapter twelve of the *General Theory*, Keynes (1936) highlights that there is a convention in the financial markets that can guide investors' anticipations. They operate on the basis of a representation of the context in which they are placed, i.e. a conventional basis allowing for collective harmonisation. The convention represents a collective reference, enabling coordinated decisions to be made.

According to Dupuy (1989), in order to coordinate, individuals must know how others have behaved in the past and others must know how I behave, i.e. everyone

[7] For more on the Economics of Convention, see Morselli (2020).

must know how to behave.

By achieving a conventional equilibrium through spontaneous coordination, it is shown that satisfactory results can be achieved, since an individual can encourage himself by following the idea that the only risk he faces is a change of news in the future, which can lead to a break in the convention. Some factors may cause a crisis in the coordination mechanisms, such as the emergence of new information that transforms the expectations of those participating in the convention. This may lead one group to defect from a convention in order to encourage others to seek a new convention. At this point, external institutional intervention is indispensable when the convention is interrupted and stops functioning, to change expectations and restore a horizon of the future. The institutional intervention serves to create a new conventional basis, to coordinate the behaviour of individuals who are in search of a future horizon (Morselli, 2020).

Institutions represent the rules of the game to which the members of a society refer to decide the contents of their interactions, defining them through political procedures as in the case of formalised constraints (constitutional or legislative norms, etc.), or as a result of adherence to informal constraints (conventions, reputations, etc.), which emerge spontaneously from the interaction between individuals. Common values, ideas, habits and concepts mark institutionalised interaction (Hodgson, 1998). As Aoki (2001, 202) claims, institutionalisation is the materialisation of convergent expectations.

For Wagner (1992), institutions represent a certain ongoing commitment, and the continuity of the rules of the game favours the convergence of individual expectations, making the behaviour of other individuals predictable and supporting coordination. According to North (1990), the fundamental role of institutions is to reduce uncertainty by fostering a stable structure of social relations, but stability is not at odds with change. Institutions evolve from conventions, moral codes and rules of behaviour to legislation, customary law and private contracts in order to change the choices available.

Institutional change is about changing the structure that individuals impose on their actions with the intention of producing certain results. In fact, much of economic change is the consequence of institutional change. The key to improved performance is a combination of formal rules and informal constraints, and the challenge is to understand which exact combination can produce the desired results, both at a given point in time and over time (North, 2006, pp. 111-112). Thus, the overall direction of economic change reflects the set of choices made by political and economic players with sometimes divergent objectives, but with an interest in overall economic performance.

In the light of this analysis, an institutionalist-conventionalist approach shows that institutions represent social interaction and not structures implemented by rational,

maximising individuals. The combination of institutionalism and conventionalism explains the interaction between individuals and institutions, shaping goals and desires, in the process of economic change due to institutional change.

Conflict of interest

The author declares no conflict of interest.

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