

# INSTITUTIONAL ECONOMICS





NEW

SZÉCHENYI PLAN

# INSTITUTIONAL ECONOMICS

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## Week 10

New Institutional Economics III  
Evolutionary Economics

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# Contents

- Key question
- After Veblen
- Routines as genes
- Neighboring fields
- Instead of a summary

# Key question

- Evolutionary economics: an institutional research program?
  - It is more and less than that
  - Interested in institutional change
  - Examines how that change affects the economic actors
  - Builds on evolutionary psychology
  - Relies on applied research (evolutionary finance, endogeneous growth theory, etc), and uses special mathematical tools (evolutionary game theory, agent-based models)
- It supplies other NIE subdisciplines (economic history, TCE, political economy)
- Main authors: Nelson, Winter, Hodgson, Metcalfe, Dosi

# Key question (cont.)

- It is not only Veblen whose legacy counts (he coined the term “evolutionary economics”) but also Smith and Malthus (who influenced Darwin), Marx, Marshall, Hayek, Schumpeter, Alchian, Boulding, etc
- Marshall: “*The Mecca of the economist lies in economic biology.*” (1907)
- Pioneers: Nelson and Winter: *An Evolutionary Theory of Economic Change*, 1982
- Principal concepts: gradual, incremental, spontaneous change, cumulative processes, rivalry, learning, and – of course , following Darwin – inheritance, variability, mutation, natural selection, survival, etc
- Like in new economic history, the key question is: how do institutions emerge? Additional question: and how do they survive?

# After Veblen

- Veblen's theory: (dis)similarities (see presentation No 6)
  - Individual and institution: mutual determination
  - Both agency and emergence matter
  - Lack of biological reductionism
  - Role of learning and knowledge in the evolutionary process
  - No teleology
  - Interplay of instincts and institutions
  - Stages of evolution
  - Genetic analysis

# After Veblen (cont.)

- Differences a century later:
  - Lack of a Grand Theory of history, and of references to instincts
  - Sophisticated analysis, formal models
  - The economic actor (agent) and his/her interactions are in the center of attention
  - The agent and the environment change in some kind of interdependence
  - Permanent adaptation to unforeseen changes
  - Trial and error moves with a number of boundedly rational decisions
  - Cumulative learning and adaptation
  - Habits may become routines, rules, conventions and institutions
  - Routines as genes/memes?

# After Veblen (cont.)

- Repetition-imitation-inheritance
- Experimentation and discovery
- Advantages of institutional diversity
- Muddling through and learning by doing
- Adaptive efficiency, organizational inertia
- Tacit knowledge
- Path dependence of equilibrium
- Complexity and evolutionary algorithms
- Simulation of complex dynamic systems
- Models of agent-based computational economics
- Nelson/Winter: getting back from Darwin what Malthus gave him (Veblen is not cited)

# Routines as genes

- Features and problems
  - Focusing on firms; favorite example: Schumpeterian innovation in the course of competition between small enterprises
  - Routines as the organizational memory of the firm
  - Routine is understood in broad terms: all kinds of knowledge, procedures, habits (culture?)
  - The crux of genetical analogy (Winter against Friedman): the institution that survives the competition, has to make this ability hereditary if it wants to survive in the next round
  - Routines are lasting abilities, can be copied through imitation (Lamarck or Darwin?); routines may change: mutations

Does evolutionary economics necessarily have to become similar to modern biology? Does it have to seek the economic gene/meme? What is the added value for economic science?

# Neighboring fields

- In the background of the NIE subdisciplines, we have always seen the concepts of bounded rationality and endogenous preferences
- Simon, Kahnemann, Vernon Smith, etc, i.e., behavioral economics and experimental economics were also there
- Evolutionary economics needs perhaps these subdisciplines the most in order to work with the notion of routine
- A few words about the “neighbors“:
- Behavioral (psychological, cognitive) economics
- Bringing the principle of utility maximization down to earth; “framing“: perception/interpretation before decision; beliefs and emotions in the interpretation; remembering previous decisions; illusion, error, time-inconsistency, bias; behavior depends on the context; actors do not minimize uncertainty according to standard probability theory; “prospect theory“; rules of thumb, herd behavior, etc

# Neighboring fields (cont.)

- Experimental economics  
Could be a NIE subdiscipline just like mechanism design or evolutionary economics; though closer to neoclassical theory (e.g., experimental justification of perfect competition); unlike behavioral economics, it is interested less in the personal motives of decision-making than in their outcomes; studying alternative market institutions/procedures/games (e.g., auction models); establishes the legitimacy of controlled laboratory experiments in economics; microeconomic approach; theory of “induced value”

# Instead of a summary

- Is it possible to answer the questions raised in the introductory presentations?
- 1. is NIE better than OIE? 2. does NIE develop? 3. will NIE be able to produce a consistent theory (once OIE proved unable to do so)?
- Just a few remarks (instead of resolute answers):
  - NIE has won the struggle for recognition but its future depends on the results of cooperation with behavioral economics, and on the evolutionary extension of the school; the latter may lead to technical sophistication but loss of realism, thereby endangering one of the foundation principles of the school.
  - The development of individual subdisciplines is unbalanced (TCE's dominance); nevertheless, each of them prospers rapidly but meanwhile the philosophical/sociological nuances of OIE fade away.
  - If the mainstream will prove to be as flexible in incorporating NIE in the future as it has been in the past, then will it be necessary to go on pursuing a separate research program?
- All these are problems of the “West“. In Eastern Europe institutional thought has more prosaic concerns (see the following three presentations)

# Readings

## **Mandatory**

Nelson and Winter: An Evolutionary Theory of Economic Change, 1982 (chapters)

Nelson: Recent evolutionary theorizing about economic change, 1995

Hodgson: Economics in the Shadows of Darwin and Marx, 2006

## **Additional**

Andersen: Evolutionary Economics: Post-Schumpeterian Contributions, 1996 (chapters)

Vincze: Evolúció és közgazdasági elmélet, 1993

Tesfatsion and Judd (eds): Handbook of Computational Economics II, 2006 (chapters)

# Annex

- Biographical sketches
  - Schumpeter
  - Kahnemann
- Final questions
  - Predecessors/successors of the school
  - Friends and foes
  - Discoveries
  - Changes in the research program