

The institutional school of thought

A number of economists have found some or all of the characteristics of the neoclassical school of thought unhelpful, or even misleading, and have proposed alternative ways of analysing economic issues. We have used the term 'institutional economics' to cover a number of rather different theories that are opposed to the neoclassical approach for one reason or another. Although there are differences and disputes within and between institutionalist theories, they do tend to share some common features.

Institutionalist theories all reject one or more of the four core features of the neoclassical school of thought and (except for new institutionalism) make extensive use of concepts such as values, habits and cultural norms in their explanation of economic phenomena.

Individuals are seen as embedded in a society that actively shapes their economic behaviour: individual preferences are influenced by economic processes; cultural norms, and moral considerations influence agents' goals and can prevent them from following a maximizing behaviour; economic behaviour is shaped by a variety of institutions of which the price mechanism is only one. Furthermore, institutionalist economists are mainly interested in understanding processes rather than equilibrium states: they ask how things have reached a certain state and how they change.

Institutionalist theories also tend to reject the non-core features of the neoclassical school of thought. Markets are usually not modelled as perfectly competitive and agents have far less than perfect information and knowledge. Institutional theories are also usually, though not always, less formal than neoclassical models, and they rely more on qualitative forms of analysis.

Overlapping methodologies: new institutional economics

Although the overall approach taken in this module is to compare different schools of thought, you will also learn that the differences between approaches are not always clear-cut. The methodological approach of the new institutionalist school has aspects in common with both neoclassical and (old) institutionalist methodologies.

Neoclassical and new institutionalist theories share three of the four core features of the neoclassical approach: methodological individualism, rationality and equilibrium. New institutionalists, however, do not focus on the price mechanism but on the variety of economic institutions that have emerged as a consequence of the existence of transaction costs, strategic behaviour and imperfect information in the economy.