

**Área 1 - Escolas do Pensamento Econômico, Metodologia e Economia Política**

**Resumo:** Desde a origem da Velha Economia Institucional – ou, em melhores termos, Economia Institucional Original – *insights* psicológicos estão presentes. Em estudos recentes, aspectos cognitivos da Economia Institucional Original têm tido lugar de destaque. A proposta deste artigo é enfatizar outra possível fundamentação psicológica relacionada à Economia Institucional Original, que é complementar à abordagem cognitiva. O objetivo deste estudo é destacar elementos da Teoria Psicológica do Aprendizado Social como possível microfundamentação para a Economia Institucional Original. Em tal perspectiva, este artigo argumenta que os indivíduos aprendem vicariamente por meio de observação e interpretação de comportamentos tidos como exemplares. O aprendizado vicariante se baseia na compreensão sobre quem – ou o que – os modelos comportamentais podem vir a ser. Vicariamente, indivíduos são motivados a comportar-se como aquilo que é compreendido como modelo; quando tais indivíduos são bem-sucedidos, tais modelos são reforçados. Como algo social e cumulativamente aceito e/ou desejado, comportamentos exemplares podem ocorrer de forma repetitiva e tornam-se hábitos. Instituições surgem de tais hábitos e, de acordo com tal lógica, instituições podem ser compreendidas como inércias cognitivas sobre tipificações de regularidades previsíveis no comportamento dos indivíduos em sociedade.

**Palavras-chave:** Economia Institucional, instituições, hábitos, observação vicariante, aprendizado

**Códigos JEL:** B52, D02, D83

**Abstract:** Psychological insights have been present in the Old Institutional Economics – or, in better term Original Institutional Economics – since its beginning. Recently, cognitive aspects of Original Institutional Economics have been highlighted. The proposal of this paper is to offer other psychological insights related to Institutional Economics which are complementary to a cognitive approach. The goal is to emphasize elements of Psychological Social Learning Theory as a possible foundation of the Institutional Economics. This paper argues that people vicariously learn by the observation and interpretation of exemplary behaviors. Vicarious learning relies on the comprehension of people about who/what models are. Vicariously, people are motivated to behave as a model; when they succeed models are reinforced. As something socially and cumulatively acceptable and/or desirable, exemplary behaviors can take place repetitively and become a habit. Institutions arise as outgrowth of those habits. In this logic, a working definition of institution is a cognitive inertia about the typifications of foreseeable regularities in behaviors of people in a society.

**Keywords:** Institutional Economics, institutions, habits, vicarious observation, learning

**Jel Classification Codes:** B52, D02, D83

## Introduction

Nowadays, it is possible to perceive a large number of economic studies called, or self-proclaimed as being, institutionalist. Such a scenario generates barriers to understand the theoretical framework about how institutions affect in economic phenomenon. Taking this theoretical tangle into account, it is important for the proposal of this paper to make clear what kind of institutional approach is analyzed in this study. This paper explores the institutional approach called Institutional Economics by Walton Hamilton (Hamilton 1919) and, nowadays well-known as Old Institutional Economics or Original Institutional Economics. As a matter of simplification, in this paper I am Hamilton's term. Institutional Economics can be understood as an economic approach which offers an explanation of human agency based on institutions, habits and their evolution (Hodgson 1998). This branch of Economics Science relies on the tradition of Thorstein Veblen and John R. Commons.

Institutional Economics has considerable support from psychology. Veblen's first book, *The theory of leisure class* (1899), showed some psychological insights, emphasizing the importance of instincts, habits, groups and their relations to decision making (see Veblen 1899, 1914). Commons also emphasizes the importance of psychology to Institutional Economics concerning the negotiation process (see Commons 1924, 1931). In Psychology, the instinctive theory had been a prominent area until 1920's. The decline of the instinctive theory relied on analyses strongly based on unconscious and subjective issues. Such analytical perspectives inserted "black boxes" into the instinctive theory. Veblen developed his institutional approach based on an instinctive psychology (see Asso and Fiorito 2004 and Twomey 1998). The decline of instinctive psychology had been coincident with the rise of psychological behaviorism and its behavioral laws. According to Rutherford (2000) the change in psychological analysis deeply contributes to the lessening of the importance of Institutional Economics among American economics' studies. As stated by Asso and Fiorito (2004), applications of psychological behaviorism to Economics, Institutional Economics included, showed itself exceedingly restrictive as it did not take into account important issues, such as cognition.

Recently, cognitive aspects of Institutional Economics have been clearly analyzed in several studies, such as Hodgson (1985), Melody (1987), Stein (1997), and Redmond (2006). The purpose of this paper is to present other psychological insights related to Institutional Economics. The goal is to emphasize elements of Psychological Social Learning Theory, also known as Social Cognitive Theory, as a possible foundation of Institutional Economics. In doing so, this paper offers a more recent psychological background for Institutional Economics. The argument of this study is that Psychological Social Learning Theory offers complementary elements for cognitive and habitual subjects of Institutional Economics. The central point is to emphasize the relationship between people and institutions from a vicarious learning perspective which includes cognitive abilities and theorizing procedures of people based on vicarious observation and reinforcement. According to such a perspective, people are driven neither by inner nor environmental forces. There is a continuous reciprocal *inter*-action between people and institutions. That connection occurs by vicarious, reinforcing, and symbolic processes (Bandura 1971, 1986). The central point of this study is to connect Institutional Economics to a modern psychological perspective.

This paper unfolds in four more sections. The next section presents what vicarious learning – a central element in Psychological Social Learning Theory – is and its relation to cognition and reinforcement. The focus of the section is to highlight that, in a society, people learn by vicarious observation. There are observers and models, learners and exemplary behaviors respectively. The third section stresses how groups support the creation of a relationship between observers and models. It is argued that in a group there are several models regarding the same behavior that makes such performance strongly evident. It is also shown that the status content of some behaviors plays a main role in showing models to observers. The fourth section presents the idea that that behaviors vicariously learned can generate habits which have institutions as outgrowths. It is also stressed that,

in a contemporaneous world, vicarious learning based on to the observance of how institutions work and individuals understood how to behave by a reconstitutive downward causation process. Some final notes close the paper.

### ***Vicarious learning and cognition***

Individualistic and self-centered behavior is still at the core of today's Economic Science and many economists do their research in accordance with such an analytical perspective. At the same time, other scholars emphasize that this kind of approach does not really describe how decision making works. Mainly, such studies stress that people have limitations to choose just by their decision making abilities (Simon 1957, 1959), the complexity and/or uncertainty of the surroundings are barriers to individualistic choices (Loasby 1976 and Dequech 2001), individuals learn socially (Veblen 1899, 1909), or even sociability as the simplest and oft-used way to choose (Adler 1985).

From the perspective of Institutional Economics, decision making is a matter of habituation of social issues. Since Veblen (1899), Institutional Economics has been about how today's institutions – built according to yesterday's habits – support the decision making of people, as much as how today's habits will build tomorrow's institutions that will support the decision making of their time. According to this logic, there are individuals and institutions that *inter-act*, affecting the evolution of each other. Habits are performed by people but they are not just personal. They are input and output of institutions so they can be performed by, or be part of the performance of, a single individual – although habits are also outcomes of social learning. This social learning is highlighted here by the introduction of Social Cognitive Theory in an attempt to enrich the basis of Institutional Economics.

An important aspect of habits and their relationship with institutions has been highlighted recently: the cognitive features of habits (see Hodgson 1985, Stein 1997, and Redmond 2006). Despite the importance of the cognitive feature of habits, little has been detailed about how people acquire the institutional content that culminates in habitual behavior. The existence of habit-institution relationships and their features is usually highlighted, but how habits become an inner part of the decision-maker has not been the main focus. Here, this aspect of Institutional Economics is analyzed taking cognition and other psychological elements into consideration. In this item some conceptual insights of Social Learning Theory are stressed. The next section emphasizes their relation to groups and societies and the fourth section shows how the analytical basis of Social Learning Theory highlights some insights related to habits, institutions and their relationship.

In a psychological behaviorist approach, through socialization or *inter-action* with the environment people learn how to behave according to each kind of given stimulus (see Skinner 1938 and Catania and Harnad 1988). For Social Learning Theory, behavior is more than a simple stimulus-response relationship. Behavior is a result of the creation of knowledge according to the perspective of the decision maker as someone who observes and interprets what occurs around her. In this analysis, understanding is a consequence of vicarious observation. Through observation of others, people create knowledge about behaviors and learn how to behave.

Knowledge vicariously created is used as the basis of future observations, consequent behaviors, and their reinforcements, adaptations, or changes. Vicariously, a personal background to decision making is generated and reviewed. Bandura (1971) highlights that virtually all learning phenomenon results from direct experience, but that there is no need for a living situation or a physical *inter-action* among people for a person to gain knowledge. Learning can occur on a vicarious base through the observation of behavior of others and its consequences for them (Bandura 1971, 1986). As a result, just in rare cases, backgrounds for decision making are gradually built based on trial and error or individualistic behavior.

If something is vicariously learned, someone is recognized as a model of behavior.

Observing a model, a person can avoid mistakes when unknown or unfamiliar behavior must take place. A child in a new school, a teenager in her first job, a foreigner in a country for the first time, all of them observe models and learn how to behave. Sometimes this observation is voluntary, whereas at other times there is an external motivation. By observing others, people learn which behaviors generate acceptable and/or desirable responses, and concepts of acceptable and/or desirable responses are also learned. Such behaviors are recognized as acceptable and/or desirable because they are related to behaviors of models. To be recognized as an example gives to a behavior a social legitimacy. Behaviors are acceptable and/or desirable because people socially understand them as such. Concepts, reasoning, and how to put them into practice are subjects of a collective comprehension (Veblen 1899, 1906, 1909).

For social learning through vicarious observation to be possible there are two necessary actors: the observer and the model; otherwise, vicarious learning is meaningless. The child in the new school learns how to behave from friends, the teenager in her first job from her colleagues, and the foreigner from natives, if they recognize friends, colleagues and natives as models. An actor is an observer when she watches a behavior – or gives attributes to it – of another actor (the model). In a vicarious learning situation, the subsequent behavior of the observer becomes more similar to the observed, or alleged behavior of the model (Flanders 1968). When there are an observer and a model, there is a *link* between those people. In vicarious learning, a link has informative and reinforcing functions (Bandura 1971, 1986). The former takes place by the recognition of the behavior of a model as a source of how to behave in an acceptable and/or desirable way. The latter is connected to the behavior of a model as a supporting element to the behavior of an observer (this function of a link will be further explored in the following paragraphs).

Rarely do observers restrict their observation to a single link, or adopt the features of just one model. People are connected to a set of links and each connection has a different intensity, which is called the strength of the observer-model relationship (Bandura, Ross, and Ross 1963 and Bandura 1965, 1970). What determines if a link is weak or strong is the level of its reinforcement<sup>1</sup>. When the observer perceives a strong reinforcement, a strong link is formed. The link is weak when reinforcement is feeble. There are three main different types of reinforcement; two of them are discussed in this section and one is left for section *Habits, Institutions, and Reinforcement*. A kind of reinforcement directly related to the presented elements is the vicarious reinforcement. The vicarious reinforcement is the effect of observation of a model, and its behavioral consequence, after the establishment of a link. Vicarious reinforcement reaffirms the behavior of the observer through a continuous observation of the behavior of the model (Bandura 1971 and Flanders 1968).

Links and their reinforcements are also connected to the cognitive abilities of the observer. Cognition reclaims the symbolic content of behaviors (Bandura 1971, Hodgson 1985, and Melody 1987). Learning, even if vicariously, cannot take place without awareness of what the model is and what is being reinforced. Comprehension occurs through cognitive abilities. That awareness is a result of the decisions and actions of individuals who behave according to what they understand as a chain of associations developed and conditioned by previous information and their already known answers (Bandura 1971, 1986). To be aware of what was learned means that people can theorize about how to behave.

For Bandura (1986), through the observation of performance of others, a person acquires not only patterns of behavior but also a cognitive framework about what some behaviors mean. Hence, models can also interfere in the behavior of people symbolically and such representations can be used later by observers to guide their behaviors. Misunderstandings connected to behavior can be solved by symbols without taking into consideration the various possible alternatives of action. Bandura and Mischel (1965) points out that vicarious learning is encouraged through exposure to models, but once a person has developed an adequate symbolic repertoire the model can be replaced by a symbolic model which can be cognitively reinforced. As a result, there is not only a vicarious reinforcement, but also a cognitive one.

The central role of cognitive abilities in vicarious learning and its reinforcement is the observers' interpretation of symbols according to which behaviors are acceptable and/or desirable. A link is created when a behavior generates responses that are understood by the observer as acceptable and/or desirable. However, there are some situations in which the observer is unable to comprehend the relevant attributes or related behavior involved. When a scenario like that takes place, there is cognitive dissonance, which is an inconsistency between what is understood as a model and what is comprehended as acceptable and/or desirable responses (Festinger 1957 and Akerlof and Dickens 1982). When people are able to perceive that they are in a cognitive dissonant situation they try to make it stop since the link – and consequently the legitimacy of such behavior – is not present anymore. The attempt to avoid cognitive dissonance usually occurs through the replacement of the behavior-response relationship, which comes from observation of other potential models.

The classical example of cognitive dissonance is Festinger's (1957) smoker. A smoker, who has learned that the result of such behavior is ill-health (something which eventually happens to smokers), is in a cognitive dissonant situation. Hence, the acceptance of, and/or desire for, the earlier responses are not achievable anymore as a consequence, and a new link is necessary. There are two possibilities for the occurrence of a new cognitive consonance: (1) a modification of behavior because the new information about the behavior shows the bad effects of smoking, consequently the smoker may stop, or try to stop, smoking; (2) a modification of behavior that reinforces smoking; in this case the change focus is on the good effects of smoking (Festinger 1957). In both cases, the modification is not automatic and if the change occurs, the cognitive dissonance will be eliminated. However, as the example illustrates, it is impossible to affirm that the perception of demeaning information about the responses will generate modification in behavior. The earlier link does not exist anymore and the observer will need a new link and a new legitimate source to support her behavior, even if the behavior stays the same as before the occurrence of the dissonance.

Once created, however, dissonance can persist for long periods. In fact, a smoker who looks for a link to support her current behavior can face difficulties in such a task. There is no guarantee that a cognitive dissonance will be reduced. But, according to Festinger (1957), people feel pressure to produce consonant relationships among meanings and behaviors and thus to avoid dissonance. This pressure relies on social learning. In a society, there is an evolutionary path of meanings and behaviors which an individual can adopt to interpret behaviors and to generate links. Through a collective comprehension, the cognitive dissonance is usually reduced. Festinger (1957) highlights that culture or group standards can present what fits in a cognitive sense. In Earl and Wicklund's (1999) explanation, a person can achieve consistency in her cognitive abilities by taking the path that is more resistant to change.

### ***Groups and status***

Groups play a key role in introducing to people what a model is and what it means, and in reinforcing individual's theorizing procedures. Groups can be understood as a set of people who are recognized as holding similarities of some sort. This recognition generally occurs via the actions and thoughts of members of the group, such as in the case of family and friends. Usually, members of the same group observe each other in their regular activities. This is clear regarding family and friends, since they are groups in which direct and frequent *inter*-action is more likely to take place. In this case, groups tend to be a small number of people. As for bigger groups, such as social classes, *inter*-action among members has the tendency to be more indirect, though not necessarily less frequent, than in small groups. A bigger group typically can be seen as a unit composed of many smaller groups – as an example, social classes can hold subsets of families or groups of friends.

Some direct contact among people of the same group is usual, independent of the size of the

group. Indeed, to understand a bigger group as a collection of smaller ones means that the influence of a bigger group on vicarious learning is comprehended by the *inter*-action of people in its smaller groups. This means that the way a small group interferes in the vicarious learning can be reinforced by a bigger group. In other words, *inter*-action with others highlights some behaviors which are predisposed to be understood as a model by *inter*-actors.

For a person to feel the influence of what a group emphasizes and legitimizes as a model, she does not need to be considered a member of the group. When people seek to be seen as part of a group, that group has already influenced her cognition. Therefore, the ability to follow models emphasized by groups creates their boundaries of inclusion and exclusion. To be able to act according to a groups' examples is not just a matter of cognitive abilities but also of resources to put such behavior into practice. A person can understand the consumption of a specific good as acceptable and/or desirable, but she may not be able to buy it because of its high price.

Taking observer-model relationships into account, a group can be comprehended as an agglomeration of links. Within a group, links can be stronger because a group generates a snowball effect on models. Information and reinforcements snowballs take place when people are motivated to follow the behavior of others by their recognition and reinforcement in several different models (compare to Bikchandani, Hirshleifer, and Welch 1992). The identification of types in a social *inter*-action is strictly necessary for individuals to distinguish behaviors and become aware of models and reinforcement. A group tends to put emphasis on numerous models related to the same behavior. Hence, there is a behavior strongly reinforced in a group, giving observers an acute sensation of cognitive consonance and allowing their theorizing. Douglas and Isherwood (1979) stresses that a group has the capacity to exert powerful reinforcement on their members and teach them its values. Indeed, when a person is in a group, links are not just a connection between an observer and a model. As a group stresses types of behavior, they become models for every member of the group, as well as for people who would like to be considered a member. Those individuals will try to behave as a model; if they succeed, they will become a model themselves. This procedure generates a self-supporting snowball effect and, consequently, models highlighted and legitimized by the group.

How models are established, mainly in a group, takes the status content of models' behaviors into consideration. In a society where vicarious observation is central in the learning process, people know that behaving according to a model implies that they will be judged as the model. As a consequence, what are deemed as adequate and/or desired responses is necessary for successful behaviors. Veblen (1899) shows this discussion in terms of labor and consumption. For Veblen (1899), there is an upper class that executes tasks in the labor market that are not originally related to industrial activities. Such jobs are interpreted as desirable because they are not seen as something boring and/or painful as to working on the shop floor. Simultaneously, according to Veblen (1899), wherever there is private property people are distinguished by possession of goods. Therefore, success is held in evidence through exhibition of what one owns. As a result, upper classes become models because of desirable results in job and consumption events. This process culminates in the leisure class, a group which highlights models extremely visible in a society (Veblen 1899).

As a consequence, in a society or in a group there is a set of models which corresponds to their "best" achievements. These acceptable, desirable and legitimized responses, which are generated by status, are the basis of emulative features present in behavior. Something recognized as conferring status has greater value. Therefore, more influential people in a society are better models. Flanders (1968) emphasizes that a large number of psychological experimental studies conclude that effects of vicarious rewards on behavior increase its adoption as a model (the observer will look for the same success of the model)<sup>2</sup>. In situations where people are confused about the modeled course of behavior, they rely on features of potential models which they seem as symbols of status – such as dressing and possession of material goods – looking for the identification of exemplary behaviors (Bandura 1971).

Status can be understood as a way through which social power is manifested. Social power is the ability of a person, or a group, to influence the behavior of others by mediating or controlling their observation and reinforcements (Bandura, Ross, and Ross 1963 and Bandura 1965)<sup>3</sup>. Hence, a strong link occurs by the execution of social power. When models are well-established, they are recognized by people as a link. Links are presented and established by the socialization process of the decision maker. A model spread in a society or well-accepted by individuals tends to generate a strong link that reflects the level of expressivity and legitimacy of the model. When a person demonstrates a socially powerful behavior, the first reaction of others is to pay attention to it (Bandura 1971). Only by the occurrence of attention can a model and a link be established, thus attention is the first step for vicarious learning. People can comprehend by vicarious observation only if they are paying attention. Clearly, it is also a matter of cognitive consonance, because people just pay attention to what they understand as something relevant to their own behaviors.

For Bandura, Ross and, Ross (1963), people tend to adopt many of the characteristics of a model that demonstrates having social power. The effects of status on models of behavior tend to migrate from an area to another. Lefkowitz, Blake, and Mouton (1955) highlights empirical evidence about the influence of status on jaywalking. The study shows that pedestrians are more likely to cross a street on a red light when they see a person who can be seemed as a high-status individual doing the same thing. Bandura, Ross, and Ross (1963) shows empirically that younger people, who previously observed several responses to behaviors of older individuals, tend to behave according to what they understood as the better response, even in situations diverse from those already observed<sup>4</sup>. By *inter*-action with groups and by the vicarious observation of what are perceived as status and/or social power behavior, people pay enough attention to learn and recognize which behavior should be a model and generate a link. Sometimes, a model is related to more than a behavior, such as Veblen's leisure class which is connected to behaviors linked to labor market and consumption issues. In addition, models' behaviors are spread by their habitual utilization in an institutionalized way.

### ***Habits, institutions, and reinforcement***

By vicarious learning people develop knowledge about how to identify models and create links. The establishment of links is mediated by the status content of the underlying models, which are perpetuated and reinforced when observers perform accordingly. In this case, the behavior of an observer reinforces the model by a snowball effect. Perpetuation of models partly relies on the cognitive abilities of observers; through cognitive consonance, links and groups not only present what acceptable and/or desirable behaviors are but also reinforce them. Taking into account a behavior already understood, theorized and its reinforcement, it is very likely that such behavior will occur again when the person faces the same, or a similar, context. When repetition occurs, a habit may emerge (Berger and Luckmann 1966 and Hodgson 2002, 2003).

For Berger and Luckmann (1966), all human activity is subject to habituation. Any behavior that is repeated frequently becomes (part of) a pattern. A habit arises from those repetitive situations, but a habit is not simply repetition (Hodgson 2004, 2006). Habits are formed through repetition; they are influenced by prior activities and have durable and self-sustaining qualities (Hodgson 2002). A habit can be understood as a largely non-deliberative and self-actuating propensity to engage in a previously adopted pattern of thought or behavior (Hodgson 2003, 2006). Habit does not mean thought or behavior either. It is a propensity to think or behave in a particular way in specific situations and can be triggered by an appropriate stimulus or context (Hodgson 2002, 2004, 2006). Habits can be unused for a long time and, as a result, they may exist even if they are not manifested.

People who acquire a habit are familiar with a model, which generated and established the habit, and/or the environment where such a habit takes place. This familiarity comes from observation of the same model several times, which occurs not only as a result of a snowball effect,

but also through the perception of the same or similar scenario where an already learned behavior created an acceptable and/or desirable response. A habit strongly relies on cognitive consonance and the ability of the observer in theorizing what had been vicariously learned. As a consequence of vicarious learning, a habit of the observer arises from, at least, a habit of a model. A habit is based on a model frequently exposed to the observance of people; within this logic, habits express models continually and powerfully reinforced.

As highlighted before, reinforcement can be based on vicarious observation. In this case, watching behavior of models stresses a link already learned by observers. A cognitive reinforcement can also take place. When a symbolic repertoire is learned, the reinforcement can occur symbolically. Analyzing habits allows the discussion of an additional kind of reinforcement, which is reported by Bandura (1971, 1986), that of self-reinforcement. Self-reinforcement takes place when people behave based on a previous behavior they vicariously learned. This is a matter of self-regulation and it happens when what was vicariously learned becomes present in an inner part of the decision making process. The use of habits, for instance, represents a self-reinforcement.

When a habit occurs the attention of observers on models achieves a higher level in the decision making process, because the execution of a habit means that the attention which had been paid to models and the content of such behavior is now retained by the observer. Retention means that the content related to some models had been acquired by the observer and she is able to behave accordingly even without external motivation (in other words, self-reinforcement is present). Habits express retention of the model; as a result, the model can be observationally absent (Berger 1962, Bandura 1965, 1986 and Bandura and Michel, 1965). However, retention does not mean that there is an unchangeable decision-making framework, because the observer is still susceptible to vicarious learning. Even a person with her behavior strongly based on habits is exposed to the observation of models and to the influence of groups. By the same learning process previously emphasized, a person with behavior strongly based on habits can review her decision making/behavioral pattern. Self-reinforcement in this light can be better explained with the help of concept like institutions and their relationship with habits.

According to Veblen (1919) and Berger and Luckmann (1966), institutions can be seen as outgrowths of habits. As previously introduced, within a society or a group there are models which are recognized by observers according to their cognitive abilities. If a link is established, it can be used several times and culminate in a habit. A model can be related to several behaviors, thus more than one habit can be related to a single exemplary person, such as a member of Veblen's leisure class. With habits, observation is no longer necessary because the content of the model has already been retained by the observer. The disposability of observation is emphasized by self-reinforcement. The spread of habits is potentiated by snowball effects present in groups and in the social power of models. A habit well-disseminated in a society is a behavior widely accepted and supported by cognitive consonance. When it occurs, the model is not necessarily related to observance of people anymore and there is a typification of such behavior.

In a society there are types of behaviors which are exemplified by models, and they are recognized as acceptable and/or desirable behaviors. Such types result from a cumulative evolution of vicarious learning. As people learn vicariously, through time there will be a group of behaviors related to socially highlighted models. Such models are typifications of acceptable and/or desirable behaviors. Through the development of societies, those typifications spread and, consequently, they become something regular in the behaviors of those able to behave accordingly. This process not only generates habits, but also typifications of behaviors which become institutionalized. ***In this light, institutions are cognitive consonances of the typification of foreseeable regularities in behavior of people in a group or society***<sup>5</sup>.

That typification comes from what had been observed, understood and learned in society through time. Observation, interpretation, and theorization culminate in a collective approval and reinforcement. Institutions, then, come from habits, but they are more than habits. The typification

of institutions occurs through socially built ways and means to understand and express behavior. Hence, societies and groups live through institutions (Veblen 1899, 1919 and Berger and Luckmann, 1966). Institutions are the basis of vicarious learning, partly because institutional foreseeable regularities give people an effective anticipatory capacity. Information about possible consequences of behaviors is institutionally communicated. By *inter*-action with an institutional set, a person is able to anticipate the possible responses of different behaviors and theorize and regulate her behavior accordingly.

The anticipation allowed by institutions implies the establishment of a path of what is, *or what is more likely to be*, observed. This process emphasizes that the motivating and constraining features of institutions take place together (see Commons 1931 and Hodgson 2003). A “world of institutions” means that people learn socially how to behave and how to think. Then prohibitions are not something absolutely repressive, but a matter of understanding. The vicarious learning that culminates in knowledge about acceptable and/or desirable behavior is mediated and reinforced by institutions. Indeed, vicarious learning is connected to learning from observance of how institutions work or, in other words, people theorize supported by their comprehension of an institutional set.

In a social structure, where people are able to perceive and comprehend institutions and acquire related habits, observation still happens but some concepts and logics have already been learned by *inter*-action with institutions. In such situation, people are much more performers than observers. Their self-reinforcement supports the cumulative and inert features of institutions (see Veblen 1899 and Bush 1987), mainly because self-reinforcement expresses that an institutional set is the main source of external pressure *and* also a set of elements that inhabit the logic of the observer<sup>6</sup>. So, it is difficult to break this logic since both actor and structure support it. Habits already established help to select how institutions will influence observers from that time forth (Veblen 1899, 1914). As a consequence, an institutional set is part of a transmitting system of reinforcement and the basis for its own evolution. The incorporation or modifications of habits and institutional content in the observers’ self-reinforcement is called reconstitutive downward causation (Hodgson 2002, 2003, 2007).

Reconstitutive downward causation means that institutions provide an institutional furniture (Veblen 1899), or practices (Rawls 1955 and Dolfma 2009), to people who, in turn, enable them to theorize and behave despite personal limitations and the complexity or uncertainty of the environment. Downward reconstitution plays a key role in building groups and societies because it gives people the sensation that institutions and habits fit into their logic – when the opposite happens. The construction of self-reinforcement by reconstitutive downward causation relies on institutions as a cognitive consonance. The significance of an institution for the behavior of a person takes place through what the person learned about how to interpret the meaning of that institution. As a result, how people build their institutional furniture, or practices, is also a matter of cognition. An institution just exerts influence on the behavior of a person when she is persuaded by and recognizes that institution as a source of information and reinforcement regarding such behavior.

A point related to the connection between cognition and how people build their institutional furniture, or practices, regards a revision of Festinger’s (1957) smoker example. In the presence of institutions, a smoker already knows that smoking is bad for health since such information is present in the content of a large number, or almost all, institutions related to this theme. Hence, the largest section of people in a society already knows how to interpret the main concepts provided by institutions. A smoker does not learn that smoking is bad for health at some future point in time; a smoker already knows it when she starts smoking. Becoming a smoker does not happen by cognitive dissonance either, because this information is institutionally available to everybody since their early years and it is reconstitutively introduced to people. A person becomes a smoker as a result of the influence of other institutions than the ones that emphasize non-smoking habits – the majority of contemporaneous institutions. In this case, examples of the former are found in the acceptance of, or motivation from, a group which the observer would like to be identified with as a

member. Becoming a smoker occurs through a cognitive consonance with other institutions, and this is established by personal vicarious observation of the content of such institutions and habits expressed by the behavior of others.

In a world of institutions, cognitive consonance, which generates such social structures, is not strictly related to how a person understands meanings. How groups or societies present meanings to people also influence interpretation – groups and society are the usual makers and conductors of information and reinforcement. Groups can intensify, decrease or change institutional content, such as the information that smoking is bad for health. As a consequence, members and potential members of this group achieve a “personal cognitive consonance”, performing according to a “social cognitive consonance”, such as following non-smoking habits.

This “social cognitive consonance” does not mean that people cannot find consonance as stated by groups which work with a different conceptual framework, such as information with a positive tone about smoking. In this case, members of this group find consonance in smoking habits. However, in a society there is a more common core of meanings and interpretations, as for instance is the current case with negative information about smoking. This “social cognitive consonance” can be understood as cognitive inertia (see Stein 1997). The path of meanings and interpretations provided by cognitive inertia is necessary to understand a world of institutions. This is valid also for people who do not follow such interpretations because other understandings than the usual are commonly introduced to them as an alternative to what is customary. Reconstitutive downward causation is impossible without a prior system of concepts.

There are two central points to be highlighted about cognitive inertia: (1) it does not necessarily represent a more efficient way to behave - it results from the evolution of institutions in a cumulative process and from the acquisition of the underlying institutional furniture; (2) it does not imply behavioral determinism, similar to the other influences of institutions and groups in decision making. Despite cognitive inertia, there is a relative diversity in how institutional contents are observed and learned. Cognitive inertia supports the development of individuals’ cognitive abilities through vicarious learning – and, consequently, their “personal cognitive consonance” – but it does not strictly establish how understanding occurs.

Hodgson (1985, 1988) stresses that habituation also regards cognitive abilities. A “personal cognitive consonance” means that the observer is able to make symbolic connections between behavior and acceptable and/or desirable responses, culminating in the establishment of symbols about the meaning of models and links. These symbols become guidelines to behavior. When people recognize themselves as in the same or similar situation of models, links make the connection to what is understood as acceptable and/or desirable behaviors. As previously highlighted, the repetition of those scenarios, as well as observation through snowball effects and social power, can generate habits - in this case cognitive habits. Cognitive habits support the creation of institutional furniture, or practices, because they regard social patterns that recognize institutions as sources of information and reinforcement that culminate downward reconstitutions.

To sum up, groups can try to influence how people understand the content of institutions, resulting in people being approached by a number of groups. How a link is established depends on which groups are more persuasive in introducing the institutional content in a reconstitutive downward causation process. So, models express, motivate and protect a specific kind of underlying behavior and habits; this process results in a “personal cognitive consonance”. The *inter*-action between a person and groups indicates what should be observed and learned. Through time habits are acquired and self-reinforcement occurs. Within the same society there is a variation of cognitive abilities among people. However, there is a limit for this discrepancy as cognitive inertia operates to some extent.

### ***Final comments***

From the Institutional Economics' perspective, the social learning process culminates in habitual procedures of decision making. In the argument presented in this paper, those habits are created by *inter*-actions among people which take place through observation and interpretation. Such elements are responsible for the establishment of knowledge that becomes the basis for future observations, interpretations, and their reinforcements. Learning occurs by understanding the behaviors of others and their results. By observation people avoid mistakes when they do not feel confident about the decision making environment. In such a scenario, people who are watched are models and those who watch are observers. The latter recognize the behavior of a model and its response as suitable for their own.

When a relationship between an observer and a model is established, a link emerges. Links perform an informative role. Hence, the subsequent behavior of the observer will be similar to what she has understood as the behavior of the model. A link also has a reinforcing role which relies on the behavior of the model after the observer's comprehension of how to behave from the model's behavior. In this case, the model becomes a supporting element of the behavior of the observer. The level of the reinforcement determines how strong the link is. The reinforcement can occur by observation, such as in the way the link was built, or cognition. The latter regards the link as a cognitive consonance between the behavior and its response. Through cognitive abilities people become aware of which models and responses are acceptable and/or desirable.

Cognitive consonance sets up links but also breaks them. In a dissonant situation the knowledge created by vicarious observation is not useful anymore. When this occurs, people need to generate new consonant links, once again relying on vicarious learning. However, the establishment of links does not happen in a vacuum. There is a social component in vicarious learning that represents an agglomeration of links that is more resistant to dissonances. That set of consonant relations is accepted by a large number of people who also execute such consonance in their behavior. To perform according to the consonance means that people legitimize the consonance and, consequently, the models. This is what happens in a group. Groups highlight models through a snowball effect, for people are in a frequent *inter*-action that emphasizes some behaviors which are predisposed to be recognized as models by observers. As a consequence, inside a group there are stronger links that give to observers a comfortable sensation of a powerful cognitive consonance.

In a group models are established mainly by the status content of behaviors. People try to act as a model looking for the same response. When a behavior has a status showing result, it becomes something acceptable and/or desirable. Therefore, what determines who is a member of a group is really the ability to execute a status showing behavior as stated by the "model of the group". Status invokes a social power regarding vicarious learning since status is a way to influence behaviors and their reinforcements. Groups and models reinforce a behavior that then tends to be repeated when the same or a similar environment or decision making process take place. This repetition can generate habits, which can be understood as non-deliberative and self-actuating propensities for people to make behavioral connections to previously adopted standard of behavior or cognitive associations. For a habit to be generated, a strong reinforcement must occur. Once a habit is established, a self-reinforcing drive comes into action, because habits mean that what was vicariously learned is now an inner part of the decision maker. The presence of a habit means that the behavior is now retained by the observer; as a result the model can be observationally absent.

In a society, what people observe, understand and internalize is the result of a cumulative process. Individuals start all that process from existing cognitive consonances about the typifications of the behavioral content of habits. Institutions express such typification related to foreseeable regularities in behavior of people; they are consequences of what had been experienced in the society through time. After vicarious learning experiences, habits are formed and institutions arise as outgrowths of those habits. Consequently, there are socially built ways and means which

point to acceptable and/or desirable responses to behavior. Habits and institutions are expressions of that social content. Modern societies are structured by institutions, which serve as the basis of vicarious learning procedures.

As a result, in a modern society there is a socially constructed path that channels which behaviors and cognitive abilities generate acceptable and/or desirable responses. In such a context, it is possible to argue that there is an institutional set and cognitive inertia that partly supports a system of introduction and reinforcement of behaviors and their evolution. People who act under such reinforcement also support the influence of that institutional content on behavior. Both structure and actors sustain the power of institutions in vicarious learning procedures. The acquisition of the institutional content by people is referred here as downward reconstitution, or as deriving from a reconstitutive downward causation. Through reconstitutive downward causation processes people obtain institutional furniture, or practices, which are expressions of the institutional set in their decision making. The institutional furniture, or practices, gives people the sense that their vicariously learned logic fits the institutional set. That sensation takes place according to the cognitive abilities of people.

To conclude, this paper reinforces four key points of Institutional Economics: (1) institutions are not taken for granted – they are consequences of life in society; (2) in a society, people are not totally driven by the environment, and stimulus-response analyses restrict efforts toward more insightful elements of institutional nature; (3) there is no necessity for a living situation or physical inter-action among people for a person to learn; institutions are aware of what is learned or reinforced and this awareness can be transmitted without living situations or physical inter-actions; (4) as emphasized by Veblen (1899, 1909), an institution is not necessarily a physical phenomenon, which does not mean that institutions cannot have formal design, but is an outgrowth of habits and, thus, a matter of a habitual cumulative process.

### *Notes*

1. Flanders (1968) defines reinforcement as the operation of presenting a reinforcing stimulus after and contingent upon the occurrence of a certain behavior. Verplanck (1957) emphasizes that the reinforcement comes after at least a first action of the observer. For Bandura (1971) the reinforcement occurs through the performance of responses of people and their observation of the different consequences regarding their various possibilities of action, during the learning process; into this informative feedback, people develop thoughts about the kinds of behaviors most likely to succeed or the behavior which gives the better observable responses (from the observers' perspective).
2. For the radical psychological behaviorism in Burrhus F. Skinner's tradition, reward and punishment have the same effect on the consequent behavior of people who learn to avoid punishments and to look for rewards. However, Social Learning Theory emphasizes that the impact of good exemplary behaviors on the learning processes of observers is much stronger than bad examples (see Verplanck 1957 and Flandres 1968).
3. Compare to Dugger (1980) and Searle (2005).
4. In a different economic approach than the Institutional, Duesenberry (1949) provides an empirical economic study of emulative behavior and Truys (2009) presents a survey about the theme, highlighting several studies that confirm empirically the influence of status on the behavior of those who recognize it.
5. Institutions have been given diverse definitions. The particular definition used here derives from the analytical level of this research (see Hodgson 2006) and does not necessarily clash with other definitions presented by other studies in the Veblenian tradition.
6. Despite the fact that socialized people act much more as performers than observers, this paper still considers them observers just as a matter of reference to what has been previously introduced.

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