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Working Paper

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HWWI Research Paper, No. 5-3

Provided in Cooperation with:

Hamburg Institute of International Economics (HWWI)

Suggested Citation: Zweynert, Joachim (2007) : Interests versus culture in the theory of institutional change?, HWWI Research Paper, No. 5-3, Hamburgisches WeltWirtschaftsinstitut (HWWI), Hamburg

This Version is available at:

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Hamburg Institute
of International
Economics

Interests versus Culture in the Theory of Institutional Change?

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HWWI Research

Paper 5-3
by the
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ISSN 1861-504X

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Dezember 2007

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1 Introduction

In Douglass C. North's works on institutional change, his focus shifted first from formal institutions and highly rational actors (North and Thomas 1973; North 1981) to the interplay between formal and informal institutions (North 1990), and then, from about the middle of the 1990s on, to the links between culture, cognition and the evolution of institutions (Denzau and North 1994, Knight and North 1997, North 2005).¹ This has led to a corresponding shift in his basic explanation of institutional change: At the heart of *The Theory of Institutional Change* (1981) is the "neoclassical theory of the state"², according to which institutional change is mainly caused by actions of highly rational utility-maximizing political actors. In his later works, and especially in *Understanding the Process of Economic Change* (2005), the evolution of a society's institutions is above all a function of changes in the dominant belief system. As, according to North, belief systems are closely connected with the "cultural heritage" of a society, the wealth or poverty of nations is mainly due to their cultural traditions: "Economies that had evolved a cultural heritage that let them to innovate institutions of impersonal exchange dealt successfully with this fundamental novelty [the move from personal to impersonal exchange]. Those with no such heritage failed" (North 2005, 18). Had he been convinced in his 1981 work that "we should be able to predict a good deal of change in ideology in strictly economic terms" (North 1981, 50), in his latest work he claims that "the beliefs that humans hold determine the choices they make" (North 2005, 23). It is certainly a polemical exaggeration when Ben Fine and Dimitris Milonakis (2003, 567) characterise his position as a "combination of rational choice theory with irrational choice theory, the latter comprising whatever is left aside by the former". But it is fair to say that he has so far delivered two explanations of institutional change without having integrated them into a unified theoretical framework (see already Rutherford 1995, 447).

This paper suggests an analytical framework to bring these two explanations of institutional change together. My analysis rests on three building blocks: Firstly on the idea of the transfer or transplantation of institutions, secondly on the idea of functional differentiation, and thirdly and decisively on an understanding of culture as a toolkit leaving room for interest, choice and strategic action. The concepts of institutional transplantation and of functional

¹ North already mentioned ideology as a factor influencing institutional change in his publications from 1981 and 1990 (giving it more weight in the latter), but up to his post-1990 works it was not central to his considerations (see also Zouboulakis (2005, 141).

² Certainly, the neoclassical theory of the state makes up only one chapter in his 1981 book (chap. 3). However, North himself mentions only this theory when summarising the content of the book in his *Institutions, Institutional Change and Economic Performance* (1990, 7).

differentiation will be introduced in the following section. In the third one, I will re-formulate North's neoclassical theory of the state and his elaborations on culture and belief systems in terms of these concepts. Section four, then, offers a proposal of how to bridge the gap between the two approaches. Throughout the paper, I will use the example of Russia to illustrate my theoretical thoughts, a country I have been studying for years and which, as North (1999, 9) remarks, is particularly suited to explain the problems of economic change. In section five I will outline in very basic terms how the history of failed attempts at reforms in Russia might be interpreted from the perspective developed here.

2 Globalisation, Functional Differentiation and the Transplantation of Institutions

Since the fall of the Iron Curtain that had prevented people in the Eastern bloc from voting with their feet and restricted globalisation to one half of the globe, more and more governments in the world have come under pressure to adapt to the patterns of social and economic life prevailing in Western Europe and in the United States of America (in the following: "Western" patterns). Hence, the problem of institutional change resulting from globalisation in post-socialist countries and emerging markets can reasonably be interpreted as a problem of the transplantation of institutions (on this idea see Polterovich 2001; de Jong et al. (eds) 2002; Roland 2004; Oleinik 2006; Zweynert and Goldschmidt 2006). Successful transplantation always implies that the imported institutions grow together with the domestic ones. Otherwise the transplant will sooner or later be rejected. Therefore, adapting to Western patterns should not be associated with "institutional monocropping" (Evans 2004). Rather, the experience of globalisation shows that those countries are most successful which are able to fruitfully combine imported institutions with domestic traditions.

However, in order to understand the difficulties often connected with the transplantation of Western institutions we first have to understand what is so special about the Western institutional matrix. Economists in their description of Western societies tend to concentrate too much on economic aspects.³ In my view, the sociological idea of functional differentiation (for an introduction see Alexander (Ed) 1990) offers an excellent starting point for understanding the interplay between the economic system and the other subsystems of society. The European path of development since the late Middle Ages can be described as an increasing

³ The main reason of this is that modern Western economics reflects the social reality of Western societies in which there exists a highly autonomous economic subsystem of society, and this complex system needs specialised analysis. However, a central problem of developing or emerging countries is that there is not a clear borderline between the polity and the economy. Applying Western standard economics then simply does not fit the problem.

functional differentiation of society (see e.g. Jones 1981).⁴ In the course of this process, there emerged different subsystems of society, each taking over one or more clearly defined functions within the social system. What we can observe here is nothing other than the evolution of the principle of the division of labour, and therefore in the following I will use the terms “institutional division of labour” and “functional differentiation” synonymously. Like persons interacting in a differentiated production process, the subsystems of modern Western societies are at the same time autonomous and highly dependent on each other.

Well-defined property rights then can be understood as a kind of membrane between the political and the economic subsystems of society: Markets cannot exist where the state does not clearly define and enforce the rights attributed to ownership. But private property ensures that political actors are not able to redirect resources according to a *political* logic. Rather, in order to influence economic processes, they have to express their demands in the language of the economic subsystem, that is, in prices.⁵ According to the idea of functional differentiation, private property and a well-defined boundary between state and economy are necessary, but not sufficient prerequisites for the emergence of a specialised economic subsystem of society. As already mentioned, the ‘language’ of the economic system is prices. Prices can only be expressed in money. In a world of money and prices two persons pursuing an economic transaction do not (ideal-typically spoken) take into account social, political or religious matters but only economic scarcity as expressed in prices. Money thus excludes all ‘non-economic’ aspects from the communication about scarcity. This is the decisive prerequisite so that the economic system can develop its own logic. And this exclusion of all ‘non-economic’ affairs makes impersonal exchange on a large scale possible at all (Simmel 1900; Seabright 2005, chap. 4). This specialisation of communication allowed for by the institutional division of labour is the main reason why market economies have significantly lower transaction costs than non-capitalist systems, in which different matters (political, social, ideological, economic) have to be decided on simultaneously.

In a functionally differentiated society the different subsystems each develop their own logic. Hence, each of them makes sense out of its environment in different ways.⁶ In the terminology of Max Weber, in a differentiated world, the number of “value spheres” corresponds with the number of possible “rationalisations” of ‘reality’ (Weber 1958, 26). Such a

⁴ There is neither any ‘natural law’ behind this, nor was or is it a permanent development in one direction. But if we look at European social history since the Middle Ages, for this particular region over about the last 500 years there clearly was a tendency towards greater functional differentiation.

⁵ In practice, the market system is able to cope with a certain amount of prohibition and precepts as we can find in all market economies, but excessive direct political interventions inevitably destroy the market.

polycentricity of rationalities is impossible where there is a generally accepted Orthodox belief system (religious or secular) offering a single rationalisation of the world. However, the ‘division of rationalities’, which is typical of Western societies, rests on the all-decisive *common* belief that different perceptions of ‘reality’ and ‘truth’ are possible and should be tolerated – except those that would endanger polycentricity.

The institutional division of labour leads to efficiency gains, because complex processes of social interaction are split up into a number of less complex ones. This reduction of complexity enables the total system to grow more complex than a less differentiated one. The fall of the Soviet Union provides clear evidence of this. However, the Soviet Union is also an example of how a highly inefficient institutional matrix can survive for a historically significant period.

3 North’s Two Theories of Institutional Change Re-Considered

3.1 The Neoclassical Theory of the State Re-Considered

According to North’s neoclassical theory of the state (North 1981, chap. 3), the ruler is an individual utility maximiser with utility being a function of tax revenue and the stability of power. These are conflicting targets: Tax revenue can be raised by implementing an efficient structure of property rights. Making property rights more efficient, however, means decentralising them, and this potentially undermines the ruler’s power position. From the perspective of the ruler, economic growth as such is a destabilising force (Olson 1963), and this enforces the trade-off. The main forces constraining the ruler in her striving to exploit the population are her competitors within and without the state (North 1981, 27).

Re-formulated in terms of the ideas of functional differentiation and the transfer of institutions, the argument goes as follows: Economic efficiency (and thus tax revenue) can be raised by reforms increasing functional differentiation. Establishing a well-defined borderline between the political and the economic game enables each of the systems to develop its own rationality. However, such an institutional matrix is not really attractive for the ruler. She is no longer able to directly influence the flow of material resources to her and her relatives’ benefit. Also, such a differentiated order can only function if the political, religious, economic, juridical and scientific actors all develop their own rationalisations of the world – but these may easily come in conflict with the ruler’s interests. As increasing functional differentiation leads to a factual loss of power for the ruler, tight competition with other countries

⁶ More precisely, not the systems at such make sense out of the world around them, but the actors who in differentiated societies perform different ‘roles’ in each of which they act according to different logics.

seems to be a necessary condition for a lasting development towards an increasing institutional division of labour. Indeed, it has often been argued that a key factor behind the success story of Western Europe was its political fragmentation (see also North 2005, 43) which caused strong efficiency pressure.

Due to the fall of the Iron Curtain and the spreading of the new information technologies, institutional competition has been spatially extended so that more and more countries come under pressure to adapt to the principle of functional differentiation. Their situation can well be compared with that of Russia from about the 17th to the early 20th century: Located on the periphery of Western Europe, again and again the country came under economic and military pressure from its Western neighbours. Not surprisingly, the greatest economic reforms in her history were undertaken after defeats in wars against Western countries. However, as soon as external pressure diminished, reforms usually came to a quick halt and were followed by longer periods in which the rulers tried to regain a close control over all aspects of social life. In the medium to long run, this re-integrative policy always led to decreasing economic and military competitiveness, before increasing external pressure enforced new reform efforts.

According to the framework developed so far, the different degrees to which countries enter the path of social differentiation are in the first place a function of the degree of external pressure. It is easy to comprehend that due to its size and its abundant mineral resources a country like Russia was and is more difficult to set under pressure than, say, Estonia – and this certainly accounts for some of the differences between the two countries. However, this is not the whole story, as there are quite a few examples in history of neighbouring countries that set off similar reforms under almost identical starting conditions but then developed at different speeds or even in different directions, and this is what we can observe both in parts of Asia and in Central and Eastern Europe today.

3.2 North's Cultural Path Dependence Re-Considered

North refers to the idea of path dependence when he argues that “history matters” for the way in which the members of a society cope with the challenges in their social environment. To him, path dependence has its main cause in the belief systems dominating in a given society:

“It is belief systems that are the underlying determinant of path dependence ... The way the institutions evolve reflects the ongoing belief systems of the players. Path dependence, conceived this way, can account both for the pervasive influence of the past on the present and future, and also for those occasions when abrupt changes in the path of a society do occur. The latter will occur when the belief system is perceived to be inconsistent with the outcomes by that belief system.” (North 1994, 385)

According to North, path dependence in the evolution of belief systems on its part results from a “common cultural heritage”, which “provides a means of reducing the divergent mental models that people in a society possess and constitutes the means for the intergenerational transfer of unifying perceptions” (North 2005, 27).⁷ The resulting “prevailing belief system” constrains the repertoire of possible reactions to changes in the environment, and prescribes the tracks along which learning takes place in that society (Denzau and North 1994, 13-22). North does not provide a theory on the emergence of the “common cultural heritage”. What has been criticized by Rutherford (1994, 46) with regard to his treatment of “ideology” in North’s earlier works therefore also applies here: His explanation of institutional change in the end depends on a factor that is exogenously given and remains outside the scope of scientific explanation.

The story told so far is clearly one of incremental change: Bounded rational individuals equipped with fairly rough and incomplete “road maps” (a term introduced by Hayek 1952) of their environment try to maximise their utility. The resulting discovery procedure causes – within the repertoire of possible reactions constrained by the cultural heritage – incremental shifts in mental models which in turn lead to gradual institutional change, usually starting with informal institutions that are later fixed in formal rules.

However, North is aware that cognitive change sometimes takes place in a discontinuous fashion. Drawing on Thomas Kuhn’s (1962) theory of scientific revolutions, he and Denzau distinguish between periods of “normal learning” (= normal science) and of “representational redescription” (= scientific revolutions) (Denzau and North 1994, 23-5). Abrupt changes will happen if the prevailing belief system proves lastingly insufficient to cope with the challenges of the social environment.⁸ Such long-term failure cause the old belief system to be replaced with a new one (= paradigm shift) (North 1994, 385).⁹

Let me now re-formulate North’s vision of the interplay between cultural heritage, belief structure and institutional change in terms of the ideas of functional differentiation and institutional transfer: If two countries develop in mutual competition and if an institutional matrix based on functional differentiation leads to efficiency gains, sooner or later the country with the lower degree of functional differentiation will come under ‘imported’ differentiation

⁷ One detail is interesting here: This passage is almost identical with a formulation in North’s joint article with Arthur T. Denzau on “Shared Mental Models” (1994), with the difference that Denzau/North speak of “the cultural heritage”, not of a “*common* cultural heritage”. This point is important for my own line of argument, and I will come back to it.

⁸ “Failure” here would include the awareness that another society does better in coping with similar challenges.

⁹ North explicitly acknowledges that this is a somewhat “hubristic assertion since little is really known about this crucial subject, which is essential to the successful transformation of Eastern Europe and the Third World” (ibid. n.).

pressure. Success or failure of the import of functional differentiation will mainly depend on the adaptability of the prevailing belief system. This ability significantly depends on the cultural heritage. From the perspective of the paradigm of social differentiation, this adaptation will be the more difficult the more the prevailing belief system is shaped by holistic patterns. For where holistic belief systems prevail, the emergence of different value spheres with different logics within society will be hard to accept for the individuals. In a first and much simplified approximation, we may argue that if belief systems and social reality usually co-evolve in incremental fashion, the dominant belief system in a less differentiated society will as a rule be relatively more holistic than that in the more differentiated society. Accordingly, the ability to adapt would be simply a function of relative 'backwardness' regarding functional differentiation. But things are not as straightforward as that. Belief systems do not only reflect the social structure but they also have a specific component. Thus, different specific cultural legacies can lead to different abilities to cope with the challenge of functional differentiation despite similar structural starting conditions.

If we apply this framework to the case of Russia, the following story emerges: According to a common interpretation, the dominant belief system prevailing in Russia took shape under two major influences: The first of these was the ideology of the patrimonial state as it developed in 15th century Muscovy (see Pipes 1974, Part 1). The rulers perceived the country and its inhabitants as their personal property. Hence, they claimed the right to interfere into all spheres of social life and were reluctant to accept any ideas that questioned their absolute pursuit of power. A second key influence on the "Russian cultural heritage" is often seen in the legacy of the Russian Orthodox Church (see e.g. Buss 2003). A central element of the Orthodox Christian belief system is a holistic vision of society, i.e. an ideal of society as not being fragmented into different spheres (Leipold 2006, 225-9). Only a society of what one might call 'holistic harmony' was regarded to be in accordance with the Christian dogma.

A culturalist interpretation of Russian history would read as follows: Located on the periphery of Western Europe, time and again the country came under pressure to adapt to the principle of functional differentiation. As this principle contradicted the prevailing belief system, the numerous attempts to import Western institutions either resulted in hybrid and incoherent mixtures with the traditional Russian ones or they failed altogether and the imported institutions were rejected and replaced with domestic ones (Oleinik 1998, 19-21). Even after the breakdown of the Soviet Union it took only roughly a decade before the attempt to imitate the Western institutional settings was abandoned in favour of trying to

strengthen the traditional “vertical of power” and to increasingly subordinate all parts of society the political demands of the Kremlin *nomenklatura*. The persistence of the “cultural heritage” and the path dependence of institutional development resulting from it, seem to have been so powerful that even strong evidence of the superiority of a functionally differentiated order has not led to a lasting change of shared mental models.

4 Culture, Choice, and Strategic Action

The two stories of institutional change outlined in the last paragraph each deliver meaningful explanations of Russia’s relative failure to produce an efficient institutional structure, but they lack a logical conjuncture. In order to overcome the gap between the two explanations of institutional change, we need to improve on North’s understanding of culture.

4.1 Culture as a Toolkit

When economists argue that “culture matters” for economic performance, they usually understand culture as an exogenous and homogenous¹⁰ factor which influences economic performance and development but which itself remains more or less unaffected by institutional change. This holds the dangers of turning culture into a “catch-all” explanation for the differences between societies that cannot be explained otherwise (see for critique thereof: Goldschmidt and Remmele 2005, 456; Herrmann-Pillath 2006, 539-40) and of cultural fatalism: If an unchangeable “common cultural heritage” accounts for economic performance, there seems to be little one can do in order to improve the situation of poor countries. In order to do justice to North it should be mentioned that in one passage of his latest book he shows awareness of this problem: “The degree to which such cultural heritage is ‘malleable’ via deliberate modification is still very imperfectly understood. At any time it imposes severe constraints on the ability to effectuate change” (North 2005, 156). In my view, precisely this issue – the endogenisation of culture – is of crucial importance if we want to improve our understanding of the links between material interests and culture and institutional change.

Holistic understandings of culture as expressed in the term “common cultural heritage” are irresolvably at odds with the idea of functional differentiation. All societies that are more complex than tribal communities are characterised not only by a division of labour but also by a division of rationalities: People working in different occupations and fulfilling different

¹⁰ Again Douglass C. North’s works are typical of this. Although he is perfectly aware that once a society has reached a certain degree of complexity “widely disparate beliefs may be held” (North 1999, 10; see also North 1981, 7), he removes this problem quickly by introducing the notion of “dominant beliefs” (1999, 11), basic to which is the “common cultural heritage”.

social roles will make sense of the world – and their society’s history and culture – in different ways.¹¹ The arising polycentricity of worldviews is the decisive prerequisite for a society’s ability to adapt to changes in the environment, in particular to sudden, external shocks (Hodgson 2001, 334; Morgan 2005, 10) by switching between different available institutional logics (DiMaggio 1997, 278). Conversely, if culture was really stable and homogenous, rapid institutional change would hardly be possible at all (Djelic 1998, 12).

In anthropology and in sociology holistic understandings of culture as either the entire ‘way of life’ of a people or as everything a person needs to ‘function’ as a member of society have long since been replaced with more flexible ones such as “the publicly available symbolic forms through which people experience and express meaning” (see Swidler 1986, 273). The concept of culture as a ‘toolkit’ with the help of which

“actors self-consciously craft solutions to their problems through a process of bricolage, through which they recombine already available and legitimate concepts, scripts, models and other cultural artefacts they find around them in their institutional environment” (Douglas 1986, 383),

has found wide acceptance in the social sciences (see e.g. DiMaggio 1997, 267; Campbell 1998, 383). If we compare different societies in regard to the individuals’ toolkits,¹² we can both expect to find qualitative differences (different tools) and quantitative differences (a different distribution of similar tools). The qualitative differences in particular are likely to reflect some early formative influences. Cultural path dependence then determines a certain range within which a bounded variety can be recognized. Some elements of a society’s culture are certainly imbibed by all its members from their infancy. Others, however, are subject to conscious individual choice (DiMaggio 1997, 265; Kubik 2003, 319).

If people in general react to over-complexity by producing simplifying models, this will not only hold for social ‘reality’ but also for culture, which is just a prime example of what John R. Searle (2005, 3) calls an observer dependent phenomenon. In the same way in which individuals structure the sensory perceptions they receive from their social environment by referring to one out of a limited number of competing belief systems, they will adhere to a restricted number of common competing ways to define what the relevant ‘cultural heritage’ of their society is. Hence, the relationship between culture and beliefs is a two-sided one with culture not only influencing belief systems, but culture also being constructed and chosen according to belief systems.

¹¹ More than that, their understanding of the world can change depending on the role they fulfil in a concrete situation. Thus, one and the same person may judge one and the same issue differently as a manager, a Catholic, a mother, and a car driver.

¹² For example by analysing representative surveys.

If culture is understood as heterogeneous and changeable, there emerges not only room for deliberate choice, but also for strategic action of political entrepreneurs.¹³ If the cultural identity of individuals in a society is a strategic factor in regard to their belief system and thus (in democracies) also to their voting behaviour, strategic actors have an incentive to spend resources on influencing other individuals' cultural identity.¹⁴ As the activities of such strategic actors aim at the definition of the cultural heritage of a society, I suggest the term "cultural entrepreneur" which according to my knowledge has been introduced by the Polish political scientist Jan Kubik in 2003 (319). The cultural entrepreneur is an entrepreneur in the Schumpeterian sense (Campbell 2006, 507-8) who, for strategic purposes, produces novelty by recombining elements already existent in the cultural toolkit of society.¹⁵ An important task of the political entrepreneur willing to pursue 'westernising' reforms is to introduce new ideas into the belief systems of her or his fellows. In doing so, it can be assumed, s/he will be the more successful, the more s/he manages to 'sell' the imported ideas and institutions as compatible with 'the' cultural heritage of the importing society.

4.2 The Toolkit Concept of Culture in Action

In order to illustrate the theoretical implications of the toolkit concept of culture for the theory of institutional change, let us again start from a scenario of two countries with different degrees of functional differentiation developing in military, political and/or economic competition. Due to cultural variety, the toolkits in both societies contain elements that are compatible with functional differentiation as well as elements that are not. As periods marked by gradual co-evolution of beliefs and social reality make up the larger part of history, there will *ceteris paribus* be relatively less "pro-differentiation" and relatively more "anti-differentiation" elements in the less differentiated society and vice versa. Further, we can assume that the pro-differentiation elements in the less differentiated society will be the stronger the more intense cultural and personal exchange with the more differentiated society is. These two determinants of the composition of cultural toolkits are of a structural nature. As mentioned in section 3.2, the specific cultural legacies (not forming a homogenous whole but consisting of a certain quality and distribution of tools among the individual members of

¹³ As Carsten Herrmann-Pillath (2006, 544) aptly puts it: "Since culture is meaning, people are also able to manipulate meanings for the sake of their individual interest."

¹⁴ It deserves to be mentioned that in his 1981 book North explicitly spoke of "investments in legitimacy" and of "ideological entrepreneurs" who invent and distribute new ideologies (North 1981, 54).

¹⁵ By emphasising the ability of political entrepreneurs to set new issues on the political agenda, thus to create novelty instead of just passively adapting to the preferences of the electorate, the idea of cultural entrepreneur-

society) will disturb the process if they promote holistic belief systems and hence strengthen the anti-differentiation sentiments (which we can expect to be relatively strong for structural reasons anyway), and vice versa.

If functional differentiation is suddenly imported into a previously less differentiated society, there emerges a gap between social ‘reality’, belief systems and cultural toolkits. The key problem then consists in the different speeds of adaptation (see Roland 2004). Usually, this issue is reduced to quickly changing formal institutions on the one hand and slowly changing informal institutions on the other. The approach developed here allows for a further differentiation. As North (2005, 83) convincingly argues, belief systems are always a “blend of ‘rational’ beliefs and ‘non-rational’ ones (superstitions, religions, myths, prejudices)”. In my view, it is more precise to speak of different degrees of consciousness here (Soe and Creed 2002). The more an individual is conscious of a determinant of her or his behaviour or thought, the more easily and quickly s/he is able to change it (this is to say, the more this determinant becomes object of deliberate choice). Belief systems and culture both contain elements the individuals are conscious of and such they are not, but the share of unconscious elements can be assumed to be higher in culture than in belief systems. It follows from these considerations that there are three levels of adaptation speed, with formal institutions changing the fastest (sometimes over night) and culture the slowest, while the adaptation speed of belief systems lies somewhere between the two.¹⁶

This has two implications. Firstly, tensions can emerge at two levels, namely between ‘reality’ and belief systems, and between belief systems and culture, and the lasting success of the transplantation of institutions depends on whether such tensions can be overcome. A particularly relevant scenario would be that a persisting gap between expectations (based on a majority belief system) and ‘reality’ leads – as North would predict – to a relatively quick shift in the dominant belief system which is, however, not culturally sustained. If the new belief system does not strike root in the cultural toolkits, in the medium to long run it will – despite the original shift in belief systems – be either modified so that it fits the cultural toolkit, or it will be rejected. This would result in a failure to achieve lasting changes in the formal institutions. As I have argued in two papers on the debate about transition in Russian economics between 1987 and 2002 (Zweynert 2006b and 2007), this is precisely what happened

ship has much in common with the evolutionary economic theory of politics as suggested by Tilman Slembeck (1997) and Michael Wohlgemuth (2002).

¹⁶ This is a simplification however, as there are elements in both belief systems and culture that change quite rapidly, i.e. those the individuals are conscious of and which they can choose, and elements that are rather persistent. The statement that belief systems change more rapidly than culture therefore refers to the average rate of change, so to speak.

in Russian economic discourse: Around 1990 there was a brief period of enthusiasm for Western liberal economics which could not be sustained in the medium to long run and was soon replaced with concepts more compatible with the prevailing habits of thought. Much speaks in favour of the thesis that the recent development in Russian economic policy reflects what one might call a “failed transition of the mind”.

Secondly: Success or failure of the transfer of institutions mainly depends on the right selection of institutions to be transplanted, their adaptation to domestic conditions, and the political actors’ ability to ‘sell’ reform concepts in a way that makes them appear as fitting and familiar. As I am concerned here with issues of culture and ideology, I will concentrate on the third point. The acceptance of reforms can be increased by ‘packing’ the ideas and institutions to be imported into a rhetoric that emphasises their compatibility with ‘the’ cultural heritage of the importing society and/or by re-inventing the country’s historical past in a way that emphasises the cultural compatibility between domestic traditions and reforms. In this context, Alfred Müller-Armack (1932, 213), the inventor of the term “Social Market Economy”, stressed the role of “half true, half invented stories”¹⁷: In order to push through a political agenda, one of the most promising strategies is to tell stories which sound familiar to the audience but which at the same time ‘smuggle’ a new message into people’s minds. Culture, then, is not only a constraining variable for the political entrepreneur, but also an enabling one (Campbell 1998, 394; Thelen 2002, 213). However, as she or he still has to fit new ideas into the existing domestic toolkits, Margaret Weir (1992) aptly speaks of “bounded innovation”.

As we are dealing here with strategies that have to be developed for specific societies, I confine myself to a limited number of examples. A particularly instructive case of successful institutional adaptation is the German “Social Market Economy” (Klump 1997; Zweynert 2006). Post-war development in Western Germany certainly took place under guidance of the Western Allies, especially the USA. At the same time, there were local actors (economists and politicians) who were aware that the economic reform programme needed to be fitted into the traditions of the country. The concept paid tribute to the holistic traditions of German thought by claiming to reconcile social integration with the market and by combining market liberalism with a rather conservative vision of social life. Making up for ‘destabilising’ differentiating reforms through cultural conservatism is one of the standard strategies of reformers aware of the necessity to ‘take along’ society on the path to reforms. This principle is very obviously at work in today’s Turkey, where a moderately Islamist party is most success-

ful in both pursuing consequent market reforms and in finding broad public support. A typical example of cultural “story-telling” is the so-called ‘neo-conservative revolution’ in the USA, when the low tax/lean state policy was advertised with reference to traditional US-American family values (Campbell 1998, 395-98). It was also family values that South-Korean managers regularly referred to when it came to the task of managing large enterprises without having the Western experience of impersonal, horizontal interaction on a large scale. The image of the big company as an ‘extended traditional family’ helped to turn an imported and alien institution into something that could be coped with by applying domestic cultural tools (Campbell 2004, 60).

These examples show how actors engage in the “translation” (Djelic 1998, 272; Campbell 2006, 506) of new ideas into a rhetoric compatible with traditional and familiar belief systems, and how they try to introduce these ideas into the domestic cultural toolkit in a process of “bricolage” (Douglas 1986, 66-7; Thelen 2002, 227; Campbell 2006, 507-8). In order to do so, the political as a cultural entrepreneur has to be perfectly familiar with the society in question. Therefore, as Marie-Luise Djelic (1998) has shown in her excellent study on the transfer of US-American competition policy to Western Europe after the Second World War, the participation of local actors seems to be prerequisite for successful institutional transplantation.

Just as reform-willing politicians will make up stories to prove the compatibility of the cultural traditions with the intended reforms, their opponents will tell stories to prove just the opposite. Whether reforms will be sustained or not then depends on the initial distribution of power between the political actors (or, in a more economic terminology, the degree of competition on the political market) (Djelic and Quack 2003, 18), the ability of the actors to communicate their programmes in a language that ties in with the beliefs of the population, the specific cultural traits, and external factors such as international business climate. Given this multiplicity of influences, one has to accept that periods of rapid institutional change are open processes the results of which are difficult to predict. Not only is the outcome of attempts of ‘Westernising reforms’ not determined by ‘the’ cultural heritage, but what the majority of the individuals regard as their cultural heritage will be, at least partly, an outcome of political clashes between actors pursuing their interests (Sewell 1999, 57).

¹⁷ His example were the German industrial lobby groups of the 1920s who had exploited the then wide-spread belief in the inevitability of growing industrial concentration in order to satisfy their interest in cartelisation.

5 Culture and Interest in the Case of Russia

To many observers, the failed attempt of introducing ‘Westernising’ reforms in Russia since the 1990s provides strong evidence of cultural path dependence in institutional change. This thesis has been developed most clearly by Stefan Hedlund, who published an in-depth study on *Russian Path Dependence* in 2005. The central argument of the book is that in the Middle Ages in Muscovy there emerged the institutional structure of a patrimonial state characterised by an almost total fusion of state power and property. By the middle of the seventeenth century, Hedlund argues, this structure locked in, and all attempts to change the institutional matrix in any fundamental way have failed so far.

According to a definition by James Mahoney (2000, 535, my italics), which is widely accepted in historical sociology, path dependence can be defined as a process that “occurs when a *contingent* historical event triggers a subsequent sequence that follows a relatively deterministic pattern.” Now, while in North the “common cultural heritage” is a factor that remains outside the scientific explanation and can thus be regarded as contingent, Hedlund – and this is the major achievement of his study – explains very convincingly how the ideology of the patrimonial state took shape under the influence of empowered and self-interested actors. It was the Russian Orthodox Church, he argues, that by “creating a virtual past” (Hedlund 2005, 117-19) provided the rulers with a religious myth that justified their claim for absolute control over all aspects of social life: the idea of Moscow as a Third Rome. According to it, the first and the second Rome (Byzantium) had fallen because the secularisation of the Christian faith (that is, the attempt to justify belief with reference to reason) had led to a pernicious fragmentation (permitting a division between belief and reason) of these societies and eventually to their decline. It was Russia’s mission to maintain and spread the true Christian faith to mankind, a view which would ensure that all aspects of action and thought would remain subordinate to the religious dogma. This teaching can clearly be seen as a defensive reaction against the beginning differentiation between polity, Church and science in contemporary Western Europe. The notion of Moscow as a Third Rome is a prime example of a “half true, half invented” story: It adopted a specific feature of the Orthodox belief (holism) and strengthened it through skilful story-telling in order to achieve a political goal.

This way, the Patrimonial-Orthodox tradition is not a randomly given “cultural heritage”, but to a significant degree the outcome of successful bounded innovation by actors pursuing their interest. Whether or not we should speak of a lock-in: Certainly the medieval Patrimonial-Orthodox ideology was internalised by vast strata of the population and could be exploited by political actors trying to immunise their claim to power against the threat of im-

ported functional differentiation. This could be observed most clearly during the reign of Nicholas I (1825-1855) when an arch-conservative policy was officially based on the formula “Autocracy, Orthodoxy and National Character”.

The Russian nihilist and atheist intelligentsia that formed in the 1850s and -60s can be regarded as a mirror image of the patrimonial state. The mixture of anthropocentrism, holism, intolerance, irreligious religiosity and superficial knowledge of Western ideas that was typical of its members had its roots both in the experience of political repression and in the specific traditions of Russian Orthodoxy.¹⁸ After the crushing defeat in the Crimean War (1853-1856), a strong external shock, had revealed the disastrous outcome of the reactionary rule of Nicholas I, Russia entered an age of ‘great reforms’ aiming at a fundamental transformation of the institutional matrix. The attempt to switch to Western patterns of social development was opposed both by conservative adherents to the patrimonial state and by the left-wing intelligentsia (who dreamt of realising the Orthodox ideal of a holistic society under the banner of peasant socialism). Consequently, the thin stratum of ‘Westernisers’ in science, administration, and politics were under permanent cross-fire from both sides.¹⁹ Indeed, it was a ‘coalition’ between the forces of the left and right that put an end to the reform period under Alexander II: Only a couple of days before the Tsar was to sign a document that would have come close to a constitution he fell victim to left-wing terrorists, and this was the very opportunity the reactionaries had been waiting for in order to take over.

However, the reactionary turn could not prevent the cultural transformation that had set in with Alexander’s reforms from continuing. The decade between the First Russian Revolution of 1905 and the outbreak of the First World War saw a Russian ‘Silver Age’ in which the intellectual life of the country freed itself more and more from the panmoralism of the leftist intelligentsia. We simply do not know how Russia’s history would have continued without the First World War. The October Revolution was the result of this external shock and of domestic traditions. In my view, North and others grasp only half the truth when they claim that Marx and Engels had delivered the belief system for Lenin and his comrades (North 2005, 3-4). Rather, when Marxism was imported to Russia it mingled with the intellectual traditions of the Russian intelligentsia that were strongly influenced by Russian Orthodoxy

¹⁸ A remarkable number of Russian activists in the revolutionary movement had a religious biographical background.

¹⁹ This became obvious in the debate on the dissolution of the *obshchina*, the Russian rural commune in the late 1850s. Only a small group of liberals recommended the introduction of private landownership, whereas both the Russian conservative romantics and the socialists fought for the preservation of collective landownership.

(Zweynert 2002, 262-65).²⁰ The Russian Bolsheviks proved to be excellent cultural entrepreneurs able to fit the atheist “religion” of Marxism into the habits of thought of those parts of Russian society that had not yet mentally arrived in the 20th century. Since the 1930s, when the CPSU began officially propagating a nationalist version of socialism, the party used Marxism-Leninism to prevent the inflow of Western ideas, thus to advert functional differentiation and to justify its absolute claim to power. This exploitation of a (pseudo)religious dogma in order to justify absolute state power is reminiscent of the Russian Middle Ages. And as has been often and rightly argued, the doctrine of Russia as the cradle of the World Revolution was nothing but a transformed version of the idea of Moscow as Third Rome. The Bolsheviks exploited a part of the cultural toolkit of Russian society that – and this is the decisive point – had been in decline since the second half of the 19th century but was still strong enough to be revived by skilful cultural entrepreneurs pursuing their political interest. In this sense, again, the problems we can observe in today’s Russia definitely are closely connected with the country’s history and culture (and indeed with traditions reaching back to the Middle Ages), but to a significant degree this heritage was made up by the actions of self-interested actors.

Much speaks in favour of the thesis that when Gorbachev came to power the lock-in of majority beliefs incompatible with a social order based on functional differentiation was much stronger than it had been at the eve of the October ‘Revolution’. Up to the middle of the 1980s political leaders and the majority of the population were convinced of the competitiveness of the social order of the USSR. The CPSU never managed to fully unify belief systems, so there were always dissidents. However, in striking contrast to most countries of Central Europe, there was never any significant bourgeois/liberal underground discourse in the Soviet Union (see Kubik 2003). This is an important reason why (again in contrast to Central Europe), after the breakdown of the socialist system there were no actors able to ‘translate’ Western reform concepts to suit the Russian cultural context and to take society along the path of Westernising reforms, and this was certainly one of the main reasons for the failure of reform. As a result of the chaotic Yeltsin-era, the term “democracy” is utterly discredited among the Russian population. Nearing the end of Putin’s reign, it becomes ever more obvious that his government has skilfully exploited this experience for both a reappraisal of the Soviet past and to reinforce the feeling of “being culturally different” from ‘the West’. This “being different” has always been and remains to be a “half true, half invented” story: There is no doubt that there is a difference between Russia and the West caused in par-

²⁰ In my view, D.B. Zilberman (1977, 363) hit the nail on the head when he argued that “Marxism only ‘re-

ticular by the Orthodox legacy, but the fact that the authoritarian rulers again and again exploited this cultural difference to secure their power position is the more relevant thread in Russian history.

6 Conclusion

Giving up the notion of culture as something homogenous, 'God-given' and unchangeable, and replacing it with the image of a heterogeneous 'toolkit' allows to bridge the gap between interests and culture in the theory of institutional change. This toolkit so to speak provides the ground on which competing political actors as cultural entrepreneurs can play in order to push through their interests and political agendas, both constraining them and enabling them to engage in bounded innovation. Thus, culture turns into an important strategic factor of policy-making.

It goes without saying that understanding the links between culture and interests in institutional change calls for a broad co-operation between the social sciences. I see the main contribution of economics in revealing the interests behind the creation of culture. Especially the evolutionary theory of politics seems to deliver promising points of departure for historical analysis focusing on cultural entrepreneurship by self-interested actors. In my view, taking into account the role of power relations especially would help to define what 'the' relevant cultural of a society is. Here, economists certainly have much to learn from sociologists but also from original institutionalists, who were quite aware of this problem.

The fact that cultural legacies often have a rational core does not prevent them from being internalised and thus becoming an unconscious part of individual socialisation.²¹ As I have argued in paragraph 4.2, people are much better able to change such elements of their behaviour and thought they are aware of than those they are not. In societies in which cultural factors seem to hamper economic and/or political development, it is thus important to 'un-lock' cultural legacies by making them the object of public debate. By revealing the interests behind the formation of culture, institutional economists certainly have much to contribute to such 'enlightening' debates.

This brings me back to Russia, where it is encouraging to see how reform-oriented economists have now become more willing to enter the discussion on traditional Russian values and their significance for the transition and reform process (see e.g. Yasin 2003, Naimushin 2004; Kuzminov et al. 2005), an issue that until recently they had left to national-

minded' the popular Russian consciousness of its traditional way".

²¹ For an outstanding analysis of the cultural socialisation process and the problem of unconsciousness see Berger and Luckmann 1966, 59-72.

ist authors. In my view, this debate is prerequisite for a successful future reform policy, for if one thing is clear it is that the attempt to take over Western institutions without systematic modification and without strategies for ‘taking along’ society has failed disastrously. It is less encouraging that due to the high oil price (and hence the decreasing external differentiation pressure) there are no good reasons to expect a turning away from the re-integralist economic policy in the short to medium run. However, as the current developmental path will definitely not allow Russia to catch up with democratic and economically free countries, the next external shock is certainly to come. It can only be hoped that at that moment both the Russian elites and the Western advisors will be better prepared than they were in the early 1990s. Improving the understanding of the links between culture and interests in institutional change may prove to be not the least important piece of the jigsaw in this preparation.

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