



## A BRIEF APPRAISAL OF THE CONTRIBUTIONS OF INSTITUTIONAL ECONOMICS

John B. Ewing, Norman, Oklahoma

In economic theory there are different classes of theorists. Some are quite conservative and even seem to have a vested interest in the orthodox type of reasoning while other schools are more liberal and use inductive as well as deductive reasoning and approach reality through the study of social and economic habits which have become institutionalized. Through the realization that orthodoxy was limited in its scope and through the effort to broaden the bases of economic theory many positive contributions have been made in the development of institutional thought. At the same time the literature of institutional economics is permeated with criticism. We are familiar with some of the criticisms of the classicists. The Nationalists (Lauderdale and Raymond) had pointed out that there was no necessary correspondence between individual private pursuit of wealth and public good. Then they attacked the materialism of the Classicists. The methodological criticisms are found especially in the Historical School of Germany. After criticizing political economy because of its individualism and at the same time because of its cosmopolitanism, they insist that we are not ready to formulate a theory of value. We must first collect a vast amount of historical, anthropological and statistical data.

### THORSTEIN VEBLEN

In considering the criticism of classical and neo-classical economics we must give a prominent place to the versatile American institutionalist of the late 19th and early 20th century—Thorstein Veblen. Veblen defied an institution as a widespread social habit. He believed that the task of economics is to account for economic behavior, not what each individual does, but what usually happens—what *Society* does. This is just opposite to the work of the classicists who emphasized the individual and self-interest. Veblen held that if you want to find out how an institution acts and is going to act YOU HAVE TO FIND OUT HOW IT EVOLVED. This is the big thing

as far as Veblen is concerned. The German Historical School desired to use inductive reasoning on the facts and arrive at conclusions; Veblen had a greater interest in the attempt to find out how the institutions came about. Karl Marx was Hegelian and tried to discover facts and would then use them to prove that something was really going to take place. On the other hand Veblen was dynamic and believed that society was dynamic and ever changing with no possibility of a level equilibrium.

The particular charges of Veblen against the orthodox classical and neo-classical doctrine are as follows: (a) He alleged that classical economics was taxonomic. By this charge he meant that it was classificatory. (He undoubtedly shows his natural science background here for this term is used much in that field). "Economics as it left Cairne's hand, so far as his theoretical work is concerned, comes near being taxonomy for taxonomy's sake. No equally capable writer has come as near making economics the ideal dismal science as Cairnes in his discussion of pure theory."\* Professor Clapham of the University of London no doubt had this idea in mind when he talked of the "empty economic boxes," that is neo-classical economics would classify things and place them into empty economic boxes. (b) A second charge against orthodoxy hurled by Veblen was that it was tautological. By this term he meant that it was repetitious, and involved needless repetition—constantly repeating itself. (c) A third charge was concerning animism. Especially did he find this in Physiocracy but it was also permeating other doctrines. He was thinking of the quasi-spiritual ground of animism. He said there was "discernible a tone of dispassionate and colorless 'tendency' about the Physiocratic animism, such as to suggest a wavering toward normality." He went on to say that the "Physiocratic animism was of a high grade—a highly integrated and enlightened, but after all, retaining very much of primitive force and naivete which characterize the animistic explanations of phenomenon in vogue among the untroubled barbarians."\*

Veblen charged that orthodoxy was tinged with hedonism and was almost vicious in his attacks on John Bates Clark in this regard.\*\* Finally we should notice the discrepancy which Veblen saw between ideas of different economic groups. The business man is busy seeking profits while the engineer and the technician is busy making goods. The enterpriser is not primarily concerned about making goods. Veblen writes:\*\*\*

"The typical American business man watches the industrial process from ambush, with a view to the seizure of any item of value that may be left at loose ends. Business strategy is a strategy of 'watchful waiting,' at the centre of the web; very alert and adroit, but remarkably incompetent in the way of anything that can properly be called 'industrial enterprise.'"

In his "Higher Learning in America" Veblen considers this "inglorious posture" of the American business man. It is this same book that he takes the Schools of Commerce to task with their courses in Salesmanship and Financiering, and their training for the development of this "inglorious posture."

In this indictment Veblen accuses the business enterprisers of "sabotage," "conscientious withholding of efficiency, the protective tariff, cur-

---

\*Veblen—Place of Science in Modern Civilization, pp. 67-69.

\*Place of Science, etc. p. 93

\*\*See chapter on "Professor Clark's Economics in Veblen's Place of Science in Modern Civilization."

\*\*\*Higher Learning in America, p. 206, fn.

talling production at a time of slack demand, etc." Veblen, however, has failed to distinguish between various grades of sabotage. There may be a high brow sabotage and again there may be low brow sabotage. We have to introduce the "rule of reasonableness" here as well as in other fields and stop to consider the opportunities of members of the enterpriser class in making a living.

In making an appraisal of Veblen we should recall that he has been given credit for "stirring up the animals" in Economics and starting modern movements. That his influence is important cannot be questioned but at the same time we should remember that developments in other social sciences have had influence on economics as well as writers like Veblen within the field. His criticisms have been penetrating and he has had some part in the development of positive institutional method even though so much of his writing was critical.

### JOHN ROGERS COMMONS

Perhaps the most constructive contribution to institutional economics has been made by Professor Commons.\* His contribution is more positive than that of Veblen. He does not spend so much time criticizing the orthodox economic systems as does Veblen.

When we consider the theories of value of Professor Commons, it is important to consider his approach to the field. It will be recalled that he came into the consideration of value through the study of labor economics and through his activity in legislation and in the regulation and valuation of public utilities. In trying to find out whether or not new laws were constitutional the question of reasonable value was confronted. Court decisions were studied assiduously. In the sense that it was necessary to work new ideas of value in new situations, it might be said that Mr. Commons was self-educated. Mr. Commons had read Veblen's criticisms and his suggestions that an "evolutionary theory of value must be constructed out of the habits and customs of social life." But of course Veblen had not studied court decisions. So Mr. Commons works out his theory of institutional economics which is going-concern-volitional theory. He implies conscious directions while Veblen in his evolutionary theory apparently did not. In a recent study Mr. Commons has defined an institution as "Concerted Control of individual action"\*\*\* and then he adds "institutions arise because people do not act alike. They arise from conflict of interests, and that is the reason why Adam Smith could not stand for them. His (Smith's) presumption of self-interest was his divine harmony of interest, but where there is conflict of interest there must be concerted action to compel conformity of individuals to the activities of others."

The theory of Value of Commons is built around the transaction where two or more wills are acting within the sphere of mechanism and scarcity and working rules. The working rules determine the limits of the transaction. The transactions are (1) unauthorized, (2) authorized, and (3) authoritative. In the first we have master and slave. In the second, freedom may illustrate the status, and third, control by the State. A transaction has five parties, actual buyer and seller, potential buyer and seller and the fifth party as Umpire. Five principles of variables serve as guides

\*Space does not permit consideration of the contribution of many other important writers in the field of Institutional Economics. J. M. Clark is among those whose contribution is noteworthy.

\*\*Lecture before the Graduate School of the U. S. Dept. of Agriculture, March, 1930.

to the transaction are scarcity, efficiency, futurity, custom and sovereignty.

An illustration of the use of the variables may be found in a trade agreement between employers and employes. If it is in the coal mining field we know that a certain amount of labor is needed. By controlling the supply of labor, the scarcity variable is in evidence. The employer may show his efficiency by combining the factors of production and in the maintenance of morale. The sovereign (the State) may fix the hours and conditions of work and related matters. In the effect on future prices and society futurity enters the picture. Custom methods of wage payment and the conditions of abrogation or agreement constitute the working rules. The custom may vary from one region to another.

So we see that this is not an individual marginal productivity proposition but rather it is a social proposition. Wages in one region may be different from those in another; hence the institutional factors may be reflected in several markets. If certain institutions are of uniform usage, then they may comprise a going concern.

#### GENERAL APPRAISAL

1. Certainly the work of the institutionalists is very important in its relations with other social sciences. It uses methods that are a good deal the same and exchanges ideas. The old classical deductive reasoning however, borrows little and gives little.

2. Institutional Economics helps to give an understanding of a dynamic society. Sombart\* has recently stated that there are three kinds of economics: (1) Ethical, moralistic, represented by Smith and others; (2) Classificatory Economics represented by Ricardo and the neo-Classicalists; and (3) Economics of Understanding, represented especially by the German Historical School. Supporters of institutionalism would also claim that it is a part of Economics of Understanding. The German Historical School and the Institutional Economists both use the historical, evolutionary approach. The Historical School would have thrown orthodox economics completely overboard, however, while the institutionalists use some of it.

It is perhaps correct to say that the Historical School was interested in inductive study in order to prove that something was going to take place. Veblen, on the other hand, did not believe that change would cease or that things would be brought to a level or equilibrium. Commons has a place for conscious direction with his volitional theory, but within limits he finds continuous change.

3. Professor F. H. Knight has stated that one of the purposes of Classical and Neo-Classical orthodox reasoning is to counteract the stupid reasoning of the men in the street.\*\* Admitting that orthodox economics has possibilities in this regard can we say so much for institutional economics? Or is it necessary to stop and say we must use the evolutionary method and get this thing in its proper setting? Is this thing a going concern? Is it genetic? No conclusive answer can be given here but it must be said that the normality achieved in the orthodox reasoning is quite apart from reality. Is not the reality of the institutional economists preferable to the orthodox group? The marginal productivity doctrine was in the opinion of the late Professor Blum so completely out of

\*A review of Sombart's recent work may be found in the *Journal of Political Economy*, April, 1931.

\*\*See his article in Tugwell: *The Trend of Economics* (1925).

accord with reality that it amounted to distortion.\* The marginal doctrine was premised on perfect competition, perfect mobility of labor and capital, which does not exist. When monopolies, holding companies, labor groups and governments control activity where can one find perfect competition?

(4). Briefly the conclusion is reached that Institutional Economics is more than a passing fancy. It is not yet bankrupt, and while there may not be a possibility that it will become the main branch of economic theory, at least it is more than a mere supplement.

---

\*Blum—*Labor Economics* (1925) p. 439.