

TO THE SPRINGS OF A MODERN ECONOMIC THEORY: INSTITUTIONALISM

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Abstract

We offer in a few rows written on this theme, some of the bench-marks –persons and representative ideas –which define the beginning of institutionalism in the economy. It's a field already felt out and with a few chances for news. What we would like to distinguish aim a reseating of a place and the importance of some founders in their work of founders of institutionalism. In concrete we place G. Schmoller and C. Menger foreword to this theory. We also try to provide reasons to convince that Adam Smith was not foreign to the institutionalism philosophy and that the present representatives of the New Institutional Economics should assert him as a founder father.

Key words: institutionalism, transaction costs, currency, rule, institution, classics, neoclassic.

1 Introduction

We state from the very beginning that we intend to talk and to grasp in more secure lines bench-marks, persons and representative ideas which define the big family of economic institutionalism even if we are aware that such an objective is not an easy target.

And it is not because through the complex themes which they recommend to analyse, attached directly or indirectly by institutions and their role in organizing and social formation, institutionalists are condemned to consistent inter disciplinary digressions. On this way they become sociologists, anthropologists, politologists, psychologist, according as all these concern about convergent themes, they have all the chances to become economists. The impossibility of claiming a clear land marked territory was and remained a feature of all old and new institutionalists.¹ If something differentiates them and assures a special place in the history of economic thought, this something is tied on big themes and the level of analysis on which it situates; of the instrumentary analytically used; of the language relatively common with the accent on some key notions (institution, organization, agency, evolution, etc); of at last the unanimous faith imparted that beside the institution of contract, the ownership, transaction and institutional arrangement, it is hard to say what will really happen in the economy.

The fact that, even if they belong to the same big family, institutional economists belong to the different doctrinaire orientation complicates things, once moreover. With the same origin, the institution, Veblen and Schumpeter criticize the capitalism while Hayek and Mises criticize the socialism.

Making abstraction of their passions demonstrated in the normative space, we shall try, in the next lines a presentation on historical phases of their manifestation, having as big bench-marks not as much fixed temporal landmarks but the thematic aria which they circumscribed the investigatory efforts.

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2 The irrecognizable pioneers of institutionalism

On principle, the beginning of the institutional theory in economy is associated to the name of four Americans: Thorsthen Veblen, John Commons, Westley Mitchell and Walton Hamilton. And it is a sure fact and unanimous recognized that, actually, through their own way in which they build their analysis, against the classic and neoclassic current, they can be considered the founders with pioneer's work in the history of institutionalism.

At the same time, recent studies² attribute this role to the Austrian Carl Menger and to the German Gustav Schmoller.

The reasons, which we consider solid, hold on to the circumstance as the:

a. G. Schmoller(1838-1917):

- In opposition with the classic school which fixed the object of economic science in the perimeter of obtaining wealth, and with the neoclassic one which made the law of demand and supply the alpha and omega of the speech, he thinks that the economic science must have on sight the “anatomy of social body”. [Schmoller, 1905, 5];

- He offers, among first, a definition of the institution and organization (device) apprehending, through the first, “an arrangement agreed by the community and serving given aims ...”

- He sets aside the perfect competition as a battle between many and relative equal; the relationships between organizations can be, in his opinion, of “domination or co fraternity”;

- He argued that the economic progress of a society is supported, mainly, not by technical factors but by the quality of institutions, anticipating, in this way, on D. North;

- He makes a clear distinction between custom and the formal law underlining, in the same time, the role of rules, customs and moral norms for the economic life;

- He covering retains, that the institutions can be the crystallization of the knowledge or of the ignorance; or the idiocy, as Veblen will add later.

b. C. Menger (1849-1921)

- He was preoccupied with the process evolution of forming an institution called currency;

- He reckons the institutions as be themselves social phenomena submissive to transformation and evolution;

- Involved in the epochal quarrel of methods, he militates for adopting the hypothesis of work reductionistic revealing, at the same time, the valences of the principle of methodological individualism;

It's easy to see that through the position displayed and through the ideas launched there are reasons to place those two, Schmoller and Menger, in the rearguard of the old institutionalism.

3 “Recognized” Institutionalists

When it comes to Veblen, Commons, Mitchell and Hamilton, well-known and trained rearguard institutionalists there exists a background of ideas which unite them and which gave the mark of the current, and there also exist adequate places which differentiate them.

Broadly, the common substance of ideation of the first institutionalists is the result of the fact that they wanted to be, through the position they posted, a retort to the address of the neoclassic school and one becloud to the address of classicism.

Thus, under the influence of the German historical school, institutionalists criticize the abstractionism and pure logic, the pretension of universal truths they promoted and the cosmopolitanism of both schools. Both schools are also blamed for the static character of the analysis developed, inconsonant with the evolution of the world in general, and of the economic one, in particular. That is why the hypothesis and the demand for equilibrium, reflexes of some states, cliché of reality, it seems to be like an effort nonsensical and unworthy of a realist examination. From the same position, the American institutionalists do not excuse nor the classics (except Marx) and mostly the neoclassics because they did not realize the role and the importance of institutions in determining and explaining the human behaviour; that the key to conflicts reconciliation can be found in habits and conventions, in rules and in their enforcement. They consider the neutral landscape, torn from the socio-political conflict and populated with characters with neutral names such as producer and consumer which is present in the neoclassic analysis, inadequate to the reality and hostile to scientific spirit.

We say that the critical attitude toward the neoclassic school was an implicit one, concealed with taking up of clear position only on the direction of methodology. But even here they did not go through. We do not know what reasons explained their attitude. Trying to understand them we feel the need to make some remarks.

First, from the classic school, the old institutionalists, as well as the new ones, did not exclude Marx. And not only they denied Marx but they even used him, broadly appreciating his contribution on the line of institutional approach of the economy.

Then, the classic school, especially the Manchester one, was, really, a cosmopolitan one, with the posted pretension of a creditor of universal ideas valid outside of space and of time. If however, we have to judge retrospectively looking at the things, its position is justified. It had no rival of his size, in Europe and over the ocean. The oneness of its position in the world of economic scientific creation emphasized the statute and inspired the forms of manifestations.

Moreover, who questions today the explanatory value as well as the normative one of the sentences which come on Smith-Ricardo-Mill channel? If what it is was then called the “economic school of the West” inspired a model of economic policy which made the West and not the East a free and prosperous society, which can be the answer to our question?

On the other hand, the neoclassic critique was not concealed nor implicit, but direct and explicit. Quoting, representatively or retaining the essence from the work of Sanford Jaccoby, *The New Institutionalism: What Can I Learn from the Old?*, W. Richard Scott, believes that in an essential way, four aspects differentiate the neoclassic matrix of the institutional one [Scott, 2004, 24];

- “Indetermination versus determination. While the model accepted in a traditional way supposes <<a perfect competition and unique equilibrium, the institutionalists distinguish the pervasive force of the market and the indetermination existent even in the case of competition system >>”[Jaccoby, 1990, 318]

- The endogenous establishment versus the exogenous establishment of preferences.

The neoclassic theorists postulated the preferences or the individual wishes, while the institutionalists alleged that those preferences are shaped by the social institutions, of which activity is due to the subject of economic analysis.

- The realism of the behaviour versus simplifier assumptions. The institutional theorists alleged that the economists should use models of pragmatic economic motivations and realistic from a psychological point of view and not to accept the naïve assumptions of the utilitarians.

- The diachronic analysis versus the synchronic analysis. Denying to take over the presumptions <<indefinite in time and space>> of the neoclassic theorists, institutionalists insists upon the idea that the economists have to establish <<the way in which the economic

system gets the characteristics and the conditions which determine the modification of those features in time and space>>.[Jaccoby, 1990, 320].³

Outside of these common points present in their pioneer's work of institutionalism, there exist different notes, personal accents which particularize them.

Thus:

a. Thorstein Veblen (1857 – 1929):

- He adopts the Darwinist biological model of evolution which he considers valid even for economy. On this basis, he develops a theory of economic evolutionism through which he will explain the institutional path (the future dependence of Northian way) with the help of cumulative causality and through which he astound not only the evolution of the economy but even the one of the institutions as such;

- He proves to be mostly influenced by Marx. Just as the author of “Capital” saw in the relations of production the less dynamic factor in consent with the forces of production (the technical factor), all such Veblen imputes on the institutional inertia the lagging behind the economic system. He is ready to see in the fight class sustained by Marx a broly of “utilitarianism and rationality”.

- He is the first economist which uses the term neoclassics, on which he criticizes hard. He is, in the same time, the only one from the institutionalists which is heading against descriptivism and the historicism of German school, critique which will return, in time, against his own confreres of ideas fallen in the same sin.

- He sees in institutions “habits of thoughts and the dominant act in the social community”. But the habits of thoughts can be good or “imbecile”. And over here a classification of the institutions after this criterion and the possibility of triumph of imbecile institutions over the culture in certain historical phases.

b. John Roger Commons (1862-1945)

- He sees in the institutional economics a synthesis science, involving the law, economy and ethics. The aggregate vocation he expresses even when he tries to bring the theory of equilibrium into the evolutionist one of Veblen. He was also interested in making a synthesis between the institutional economis and the economics of organizations, fact for which the future institutionalist Herbert Simon saw himself beholden.

- He prepares the language used by the influential neoinstitutionalist Oliver Williamson by seeing in the institutional economics a science of transactions of conflict of interests but also of property rights. He is otherwise the first who offers a classification of transactions in : “merchandise, managerial and of repartition”[Commoms, 1990, 64-65, 106] On a such consideration and not only, Aurel Iancu thinks that J. Commons was “ The only one who made the link between the old and the new institutional school...”[Iancu, 1998, 541];

- He opposes the social control to the Veblenian natural order. Preoccupied by social reforms, he sees possible the replacement of the invisible hand of Adam Smith with the “court of common law” which has the fate to “select good habits” and to impose them. The selection is in this way at him an artificial one and not natural.

c. Walton Hamilton (1881-1958)

- He is the first who uses the term institutional economics science, opposing it, in principal, to the classic economics science of Adam Smith;

- Being under the strong influence of Veblen, he explains the evolution of the economy yielding from “institutional inertia”. Under the same “umbrella” he defines the institutions as “ the ensemble of social habits...incorporated in the habits of a group or in the customs of a nation”[Hamilton, 2005, 84];

- He tackles the interesting and inciting problem of institutional conversion, pointing out that an institution, like any other “human creation”, can be enslaved even to the power on which he had to control it.

d. Wesley C. Mitchell (1875-1948)

- Opponent to the abstractionism of classic and neoclassic school he builds his step departing from the hypothesis that any principle has to have a base deed. As such he replenishes the pages written with dates and numbers due to him the institutionalism falls in descriptivism.

4 Is Adam Smith an institutionalist?

We are among the ones convinced that what it was essential to be said about the economic science, was said by Adam Smith. The ones who followed him renewed, planed, updated etc. but they did not change the master’s scheme of thought. And in this scheme, our opinion is that there did not miss the institution, in the sense of rule. If we will have to give a subtitle to his basic book –*The Wealth of nations. An Inquiry into the Nature and Causes of the Wealth of Nations*-we believe as most synthesizer for what he describes between the covers of his book would be: *The rule on which wealth is obtained*. And the rule, for who is willing to infer from the context, is simple but magisterial presented and contained in the following sentences:

- the people do not bear and do not remain equal;
- exists so, a division (even natural) of labour;
- the division of labour oblige to trade;
- the trade oblige to efficiency;
- efficiency, productivity leads to the growth of individual and collective wealth.

What does it mean according to Smith, the observance of this fundamental rule? The freedom of thought and fact of the individual, the freedom, we say, of the enterprise fenceless by nothing else but the law. The freedom manifests only in the space of free market.

On this analytic basis with their stylistic accuracy without matchless they have embellished, subsequently, Mises and Hayek. The first to demonstrate once again that “the human action” (the title of his basic work) is essentially one of cooperation between free individuals. The second, to establish the border between visible and invisible, between the rules seen and respected by all and the unseen ones but necessary and which reclaim the state of right.

It would be something more to say about classics. Even if, through the continuity which Marx produced, in the sense of critics, of course, the notion on which they centred their analysis was the social class, under the philosophical- methodological report, holism was foreign to them. And then, when he explains the international trade, Smith yields up from the individual thinking that by the rule (the rule was present even here) in a civilized world, what it is good for an individual does not have a bad influence on the country.

Why did we halt with these sentences mostly on Smith and the classic school? Because we harbour the faith that, the big family of institutionalists should be convinced to assert him as founder father. They have serious reasons to do it; we believe that on such channel built on the economic but even on the ethics, social, morale too, after the example

provided by *The Wealth of Nations* and also in the *Theory of moral sentiments*, it would have been asserted more quickly and more seriously without syncope produced by the appearance and manifestation of the new institutional economy.

5 Conclusions

Many of the ideas of the first institutionalists shall constitute inspiring sources of appreciation or critics, in the approaches of the new institutionalists. The studies on the theme of the history of institutionalism mainly distinguishes the critical side with which it was received the legacy of the pioneers of institutionalism. Why so?

Because, synthetically speaking, the supply of the old institutionalists was not on the measure of suggested objectives. Veblen, Commons, Mitchell s.o. wanted to break the prints and to provide a retort of the two big schools, classic and neoclassic. And it happened with them what it happens with all of those who, opposing the ruling current, cherish from its shade of criticism, trying to replace not to build. With all the accents of originality, recognized as interesting and helpful for the economic analyse, the absence of a unique terminology and methodology, of a coherent logic as well as the scrawniness of some analysis affected by historianism and naïve empirism (under the influence of German school) at which it can be added the dim percussion of the normative floor made the institutionalist theory, in its beginning form, to be considered one with a low stake. As a matter of fact, the toughest criticism came inland when the recognized father of neoinstitutionalism, Ronald Coase, put in question "the absence of the theory" from the inheritance of the forerunners noting that in the absence of a theory, they (the old institutionalists –n.n) did not have to offer but a mass of descriptive material which was waiting to be included in a theory or by flames"[Coase, 1983, 230].

Taking as oversimplification the Coase critique we retain though the part of truth from it. The classic school was already well-known and the neoclassical one imposed itself through the names of its Nobel prizes winners representatives. The old institutionalism, despite generous and profitable ideas for the quality of economic analysis and not only, lost the battle and, up to the level of the years 1970 when the new institutional economics is enforced as a investigatory program worthy of a real scientific interest, the researches of the old institutionalists were continued rather by sociologists, anthropologists or politologists than by economists. Their effort is however meritorious because, without the pretension of assuring a continuity between the old and the new institutionalism, they offered bridges and they opened new research directions on which the new institutional economics fructified with profit.

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Notes

1. We say that this is not a bad thing. On the contrary, he comes to tie an old and fruitful tradition when the economists entered in the economy through philosophy, history, law and sociology etc. It was the dowry necessary to understand correctly the economy like a “slice” inseparable of the social organism.
2. R. Langlois, for example, wants to emphasize that Menger “ has, maybe, more rights to claim to be the saint master of the big institutional economic theory than would have any other from the first institutionalists.”[7,p.5]
3. These generalizations –especially the first and the fourth- are applied in a little measure in the case of Austrian branch of economic studies dominated by Menger and Hayek. These theorists , even if they insist on the importance of elaborating the theory and symplifying the suppositions, are interested in understanding the economic change, therefore they are rather in the favor of a more tackling evolutionist approach and of studying the economic process (see Langlois, 1986a). Their ideas supplied the evolutionist economy development.(The note belongs to R. Scott)