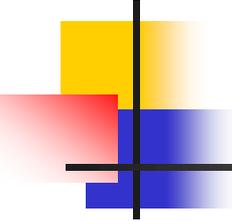


# Institutional Economics

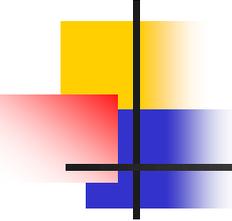
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# What is an "institutional" economist?

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- Focus on understanding the role of human-made institutions in shaping economic behavior
- Institutions may include the family, the corporation, the trade union, the financial system, the legal system, the state (government)
- Economics cannot be separated from the political and social system within which it is embedded

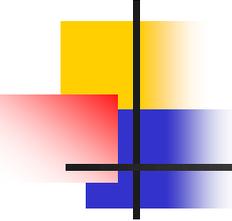


# Who are they?

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- Thorstein Veblen
- John R. Commons
- Wesley Mitchell
- Generally a diverse group of writers who have a few common themes

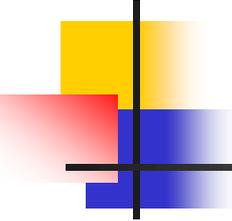
# What are these common themes?



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- Critics of orthodox economics (Neoclassical)
- Objected to the notion that the "laws" constructed by Neoclassical economists were timeless generalizations and contended instead that the economic behavior of men, like any other human activity, had to be analyzed in terms of the social context in which it was imbedded

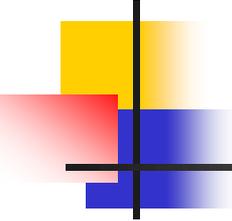
# What are these common themes? (cont'd)



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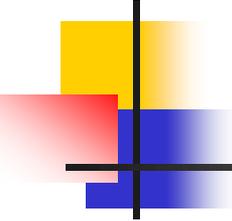
- Neoclassical economics could be applied only to special historical circumstances and in very restricted contexts
- "A gang of Aleutian Islanders slashing about in the wrack and surf with rakes and magical incantations for the capture of shell-fish are held, in point of taxonomic reality, to be engaged in a feat of hedonistic equilibration in rent, wages, and interest." (Veblen)

# What are these common themes? (cont'd)



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- Focus on collective rather than individual action
- Preference for an “evolutionary” rather than a mechanistic approach to economics
- Emphasis on empirical observation over deductive reasoning
- Generally, institutionalists do not believe in the harmony of a market system and the policy of laissez faire

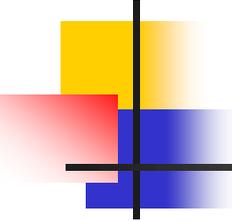


# What are these common themes?

(cont'd)

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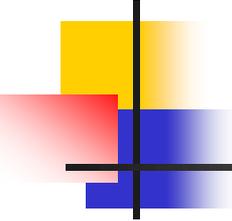
- Neoclassical economics studied allocation of scarce resources among alternative uses
- Institutionalists studied how the institutional structure evolved and how institutions reflected the prevailing social/political/economic structure



# New institutional economics

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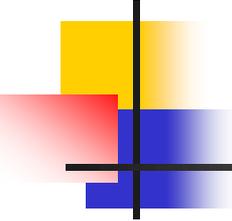
- Combines economics, law, organization theory, political science, sociology and anthropology to understand social, political and commercial (e.g., business) institutions. “Its goal is to explain what institutions are, how they arise, what purpose they serve, how they change and how, if at all, they should be reformed.” Peter Klein at <http://encyclo.findlaw.com/0530book.pdf>



# Thorstein Veblen

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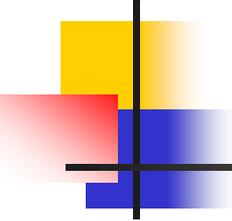
- American (1857-1929)
- PhD in Philosophy – Yale
- Graduate studies in economics at Cornell
- Professor at Chicago, Stanford and University of Missouri
- Helped to found New School for Social Research in New York (now called The New School)



# Veblen's criticism of Neoclassical theory

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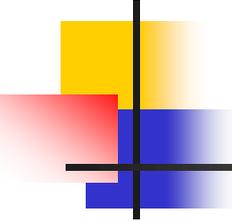
- Classical and neoclassical assumptions are “unscientific”
- He also believed this to be true of Marxism and German Historical School
- Did not believe that there was “harmony” in a market system – it did not conform to “natural” laws
- Did not believe that market outcomes were necessarily good or desirable



# Veblen's criticism of Neoclassical theory (continued)

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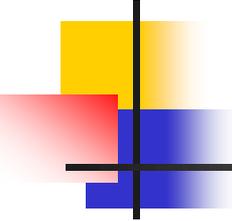
- He charged that Classical and neoclassical economics was pre-Darwinian in that it was moving toward some determined end (long run equilibrium) rather than constantly evolving in response to environmental forces (Darwin lived 1809-1882)
- This is an interesting point, I think, since capitalism is sometimes called “Economic Darwinism.”
- Did not like static analysis, too many factors are held constant (our friend, “ceteris paribus”)
- Did not believe that self interest would promote the public good



# Veblen's criticism of Neoclassical theory (continued)

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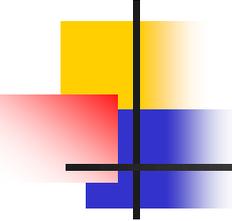
- He criticized the idea that “making profits is the same as making goods;” this may have been true in Smith’s time, but not in a more advanced industrial society where production is separated from ownership.
- Large corporations may reduce output in the quest for profits (monopoly power)
- Part of this came from Veblen’s farm background, where agrarian populists were against big businesses (Railroads, banks, etc.)



# Veblen's criticism of Neoclassical theory (continued)

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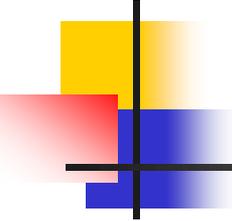
- Populism holds that the common person is oppressed by the "elite" in society, which exists only to serve its own interests, and therefore, the instruments of the State need to be grasped from this self-serving elite and instead used for the benefit and advancement of the people as a whole. A populist reaches out to ordinary people, talking about their economic and social concerns, and appeals to their common sense.



# Veblen's criticism of Neoclassical theory (continued)

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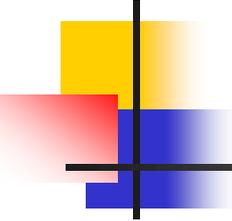
- Veblen believed that big industrialists were anti-competitive so that the whole assumption of perfectly competitive markets was completely wrong
- He also called for more empirical work to test the neo-classical models



# Veblen's Dichotomy

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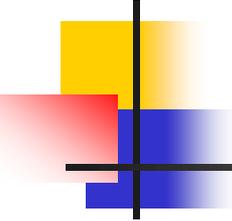
- Conflict between industrial employment and pecuniary employment



# Industrial (Technological) Employment

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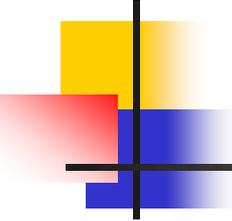
- Promotes the economic life process
- Arises from instincts of parenthood, workmanship and idle curiosity
- It is what workers do – it is good because workers make products for society



# Pecuniary (Business) Employment

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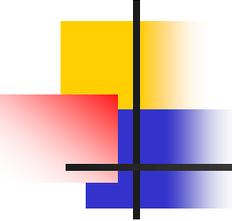
- These are the people who make money
- Basically, the capitalists
- Based on ceremonial behavior of the past
- Men engaged in pecuniary activities are parasites growing fat on the technological leadership and innovation of other men
- "The leisure class lives *by* the industrial community rather than *in* it." The "captains of industry" make no industrial contribution and therefore have no progressive function in the evolutionary process; rather, they retard and distort it.



# Veblen's Leisure Class

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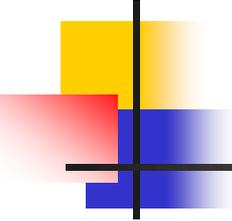
- The wealthy in the economy must have a way to exhibit their wealth, much like the witchdoctors and the powerful in pre-industrial societies
- Conspicuous consumption is the method through which the wealthy display their “predatory abilities”
- The wealthy engage in pecuniary employment only to make money, not goods
- They do not engage in “honest work”



# Conflict in an Capitalist System

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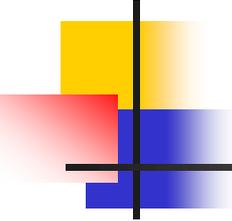
- The conflict is between industrial employment and the pecuniary employment
- Business cycles are based on the pecuniary activities of business people
- Economic society is based on conspicuous consumption, advertising, waste
- Over time, workers become relatively poorer – they strive to emulate the wealthy class with its conspicuous consumption
- This *may* lead to tension and the eventual abolition of private property
- But Veblen was not certain of this – economic society may be rescued by those engaged in industrial employment such as engineers and workers and that control of the economy will be placed in the hands of “technocrats”



# Veblen's Most Important Contributions to Economics

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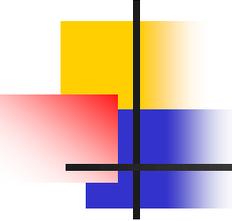
- Interesting critic but many do not consider him to be an economist
- His criticism of perfect competition model is a valid one



# John R. Commons

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- American (1862-1945)
- Wisconsin School
- Labor economist
- Helped write social reform legislation
- Not a socialist, but believed in laws to correct problems with laissez-faire capitalism



# Commons and the Welfare State

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- Regulation of public utilities
- Industrial Safety Laws
- Child Labor Laws
- Minimum wage laws for women
- Unemployment compensation laws