PART ONE

INTRODUCTION

1

American Institutionalism in the History of Economics

The arrival of institutionalism as a self-identified and self-proclaimed movement in American economics can be dated quite precisely to December 1918 and to a much anticipated American Economic Association (AEA) conference session on economic theory, featuring papers by Walton Hamilton, J. M. Clark, and William Ogburn (a sociologist), and with Hamilton's colleague, Walter Stewart, as chair. Hamilton's paper, "The Institutional Approach to Economic Theory" (Hamilton 1919a), introduced the term "institutional economics" to the literature, and from that time on, there has been discussion and debate over the nature of institutional economics, its methods, its content, and its significance.

THE STANDARD VIEW

What might be called the standard view of American institutional economics can be easily found in textbooks on the history of economic thought.[1] There are a number of evident characteristics in these treatments. The first is that institutionalism is presented as an aside to the main story. This is not difficult to understand because these books are quite explicitly designed to follow what is seen as the main line of development of the discipline from classical economics to modern neoclassicism. From this perspective, it is easy to present institutionalism as ancillary to the main narrative.

Second, the discussions reflect an unresolved difficulty in the definition of the institutionalist movement. Thorstein Veblen is always a major component of the treatments, but there are surprising differences

[1] What follows is a composite view that does not apply in all particulars to all textbooks. The texts I looked at most closely were Blaug (1978); Oser and Brue (1988); Ekelund and Hebert (1990); Landreth and Colander (1994); and Rima (1996).

among the coverage provided to other institutionalists, and all the books grapple uncomfortably with the obvious divergences among many of the leading figures. Even if one only considers the three people usually presented as the major figures – Thorstein Veblen, Wesley Mitchell, and John R. Commons – the difficulties are immediately clear. Veblen is associated with an evolutionary approach based on efficient cause, a key distinction between pecuniary, or business, institutions and technological, or industrial, requirements, and a biting critique of both neoclassical theory and real-world business practices; Mitchell is known for quantitative methods and detailed research on business cycles, an approach he established at the National Bureau of Economic Research (NBER); and Commons is associated with trade union histories, labor legislation, public utility regulation, and an analytical scheme emphasizing the evolution of legal institutions and processes of dispute resolution. Matters are not improved if the discussion includes others such as J. M. Clark and Clarence Ayres.

This problem of definition gives rise to the treatment of institutionalism as primarily a species of "dissent," because dissent from neoclassicism is indeed a shared characteristic (Landreth and Colander 1994; Rima 1996). George Stigler claimed that institutionalism has "no positive agenda of research," "no set of problems or new methods," and nothing but "a stance of hostility to the standard theoretical tradition" (quoted in Kitch 1983, p. 170). Likewise, Mark Blaug has stated that institutionalism "was never more than a tenuous inclination to dissent from orthodox economics" (1978, p. 712). This view still finds currency. For example, Oliver Williamson argues, "unable or unwilling to offer a rival research agenda, the older institutional economics was given over to methodological objections to orthodoxy" (Williamson 1998b, p. 24; see also 1998a).

Third, this emphasis on dissent from neoclassical theory reinforces the idea that institutionalism is to be placed on the fringes of the discipline. In the textbook treatments, there is usually little description of the overall character of American economics of the time (Ekelund and Hebert 1990 is a partial exception here), and often no mention at all of the fact that institutionalism was a major part of American economics in the interwar period. After all, if institutionalism was mainly dissent, how could it have been a significant part of the mainstream of economics or have contributed anything to it?

Finally, the decline of institutionalism in the post–World War II period tends to be discussed briefly and almost exclusively in terms of institutionalism failing to produce a "viable" alternative to neoclassicism in the form of a "single, cohesive, and consistent body of thought" (Ekelund and Hebert

1990, p. 478). This is an argument that, in various forms, one finds repeated throughout the literature. It holds that institutionalism failed because it was too descriptive and did not produce "theory," or at least a sufficiently well-specified theory. Examples of this argument range from Paul Homan's complaint that "the supposed existence of a distinguishable body of economic knowledge or theory properly to be called institutional is an intellectual fiction" (Homan 1932, p. 10) to Ronald Coase's dismissive comment that "American institutionalists were not theoretical but anti-theoretical. . . . Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory or a fire" (Coase 1984, p. 230).[2] This lack of systematic theory is taken as such an obvious reason for the failure of institutionalism that no further examination or comment is offered.

Thus, the standard view presents institutionalism as a minor, passing phase in the history of economics – as a movement with little coherence other than a shared disdain for orthodox theory, which, having had little impact on mainstream economic thinking, finally passed away because it was overly descriptive and produced no consistent body of thought.

AN OUTLINE OF A REVISIONIST VIEW

The primary argument in this book is that the picture of institutionalism given in this standard view is a highly misleading one. There are a number of aspects to this argument, but the general point is that understanding institutionalism requires understanding the character of American economics in the period from about 1890 through to the end of the 1940s. In many discussions of American economics, it is assumed that the work of J. B. Clark resulted in a consolidation of neoclassical economics in America (Persky 2000),[3] but this is far from correct. If we look first at the period from the late 1880s to World War I, American economics was highly unsettled in nature. Although American economics was professionalizing, there was no authoritative figure such as Alfred Marshall in England, and Marshallian economics did not dominate the American discourse. Marginalist, Austrian,

[2] Despite this criticism, Coase has made numerous remarks that would seem to place him close to the institutionalist position. Taylor (2010, p. 257) quotes Coase as saying "firms never calculate marginal costs . . . I think we ought to study directly how firms operate and develop our theory accordingly."

[3] Persky also seems to think that a well-defined institutionalist school existed in 1899. Persky seems to be talking about Veblen and a number of "New School" writers such as H. C. Adams and Richard Ely. I would rather see these writers as people who produced work that was incorporated, to a greater or lesser extent, in the institutionalist movement as it coalesced around 1918.

institutional, historicist, and various evolutionary ideas all contended and were variously intermixed. The German historical tradition had considerable influence in America due to the large numbers of economists who went to Germany for graduate training and who populated the expanding American university system (Herbst 1965; Parrish 1967).

In the 1890s, the American economics profession was diverse both in terms of a spectrum of opinion running from William Graham Sumner to F. W. Taussig and from J. B. Clark to Thorstein Veblen, and in terms of the eclecticism of many individuals. Two good examples of this eclecticism are A. T. Hadley and H. J. Davenport. Hadley was politically conservative. He sought to combine marginalist and evolutionary ideas, and his economics included a clear appreciation of the role of property rights and institutions, as well as recognition of the problems created by competition in industries with high overheads, such as railroads (Davidson and Ekelund 1994). Davenport worked in the Austrian tradition and made important contributions to the concept of subjective or opportunity cost and to the concept of entrepreneurial action (Gunning 1998), but he was also a firm friend of Veblen and much influenced by Veblen's critique of financial predation and exploitation. To be sure, economists such as R. T. Ely and H. C. Adams, among others, faced challenges to their academic careers due to their supposed socialism, and the breadth of the American academy had its limits, but it remains true that American economics was of a broad and unsettled character.

Writing from the perspective of later neoclassical dominance, it is easy to overstate the position of American neoclassicism in this period. If one had to define what "marginalist" or "neoclassical"[4] economics meant to American economists circa 1900, it would probably have been thought of in terms of the work of J. B. Clark and Irving Fisher, which argued for a theory of value based on marginal utility, a marginal productivity theory of distribution, and a theory of competitive markets. But there was much discussion and disagreement over the adequacy of this "static" theory, a frequently expressed desire for some type of dynamic theory (a desire shared by J. B. Clark himself), and many doubts concerning the adequacy of economic theory and the market mechanism itself, in the face of the new economic developments and social conflicts being brought about by American industrialization. At the end of World War I, institutionalism emerged as a movement at one end of the spectrum of American

[4] The term "neoclassical" appears to have been invented only in 1900 by Thorstein Veblen in his discussion of Marshall (Veblen 1899/1900).

economics. Slightly later, in the 1920s and 1930s, American neoclassicism also developed considerably, particularly in the hands of Frank Knight and Jacob Viner, but American economics remained relatively pluralistic throughout the interwar period (Morgan and Rutherford 1998), and was not dominated by a single perspective, either institutionalist or neoclassical.[5]

In addition to this pluralism, it is vital to observe that in the period between the wars, institutionalism was far from marginalized. Institutionalists published regularly in the leading journals of economics, held positions in major research universities (dominating the faculty at two of the top four PhD-granting universities in the country),[6] were highly active in the creation of institutions for research and education in the social sciences, had excellent links to funding agencies, were deeply involved in economic policy making, and became presidents of the American Economic Association and American Statistical Association.[7] In other words, institutionalism was fully a part of the *mainstream* of American economics. The idea of institutionalism as nothing but dissent makes this impossible to understand. This observation leads, in turn, to another crucially important point: institutionalism must have been seen to be offering something positive (potential or actual) to have attracted adherents and have gained the professional and organizational position it had. The question that arises is one of what institutionalism meant to those who were a part of the movement and actively engaged in its development.

5 Hodgson has claimed that institutionalism was the mainstream, but this is an overstatement (Hodgson 2004, p. 4). Hodgson and I are in agreement on many aspects of the "revisionist view" presented here, and Hodgson's book, *The Evolution of Institutional Economics* (2004) is an important contribution. The focus of Hodgson's work, however, is very much on the development of Veblen's specific evolutionary theory, its later abandonment by institutionalists, and on general problems of agency and structure in evolutionary explanation. The present work is centered on the nature of interwar institutionalism, its programs, institutional supports, and place in American economics.

6 The leading four PhD-granting institutions in economics in the 1920s and 1930s were Columbia, Harvard, Chicago, and Wisconsin, with Columbia being by far the largest in terms of numbers of candidates reported and Harvard granting the largest number of degrees (Froman 1942). Institutionalist faculty dominated at Columbia and at Wisconsin. Chicago had a significant but by no means dominant institutionalist complement until about 1926. Harvard Business School included Edwin Gay and W. Z. Ripley, who had clear institutionalist sympathies. Neoclassical economics was poorly represented at both Columbia and Wisconsin.

7 Institutionalist Presidents of the American Economic Association include John R. Commons (1917), Wesley C. Mitchell (1924), J. M. Clark (1935), F. C. Mills (1940), Sumner Slichter (1941), Edwin Nourse (1942), E. E. Witte (1956), and Morris A. Copeland (1957). Presidents of the American Statistical Association included Wesley C. Mitchell (1918), F. C. Mills (1934), Winfield Riefler (1941), Isador Lubin (1946), and Willard Thorp (1947).

This issue will be dealt with in much more detail in later chapters, but at this stage it is useful to make a few observations concerning the nature of institutionalism in its early years. Two related characteristics stand out. The first of these is a shared notion of science as involving some form of empirical "realism," and the second is a view of economic and social arrangements or institutions as in need of significant reform. In Dorothy Ross's words, "what fuelled the institutionalist ambition was an overflow of realism and new liberal idealism that could not be contained by neoclassical practice" (Ross 1991, p. 411; Rutherford 1997).

Realism seems to have meant a number of things to institutionalists. It certainly meant an empirical and *investigative* view of science, one that was thought of as modeled on the natural sciences. The emphasis that one finds in this literature on the application of natural science methods to economics is striking indeed. One aspect of this was Wesley Mitchell's advocacy of quantitative methods – Mitchell saw the statistical laboratory as the closest approach to the methods of the physical sciences that was possible to achieve in the social sciences – but it was by no means confined to that. Institutionalists as a group saw the scientific method as one that emphasized empirical investigation, the development of theories based on assumptions that conformed to real-world conditions, and the critical examination of theories on the basis of empirical findings. In this light, much neoclassical theory was seen as too abstract, based on assumptions not met in the real world, and frequently untested or untestable.

Beyond this empiricism, realism also meant being consistent with the state of scientific knowledge in other, related fields, particularly psychology, sociology, and law. This desire for consistency with other fields not only ruled out hedonism as a psychological foundation for economics, but was also taken as pointing to the social-psychological foundation of institutions and economic behavior. Realism also meant an emphasis on the institutional (as opposed to natural) character of the economic system, and this in turn implied that the economy was not determined by given and unchanging natural laws, but by social and legal norms and conventions that changed (and could be changed) over time.

This last aspect was explicitly linked to the issue of relevance, in the sense of relevance for the solution of pressing social problems. Problems such as labor unrest, business cycles, unemployment, poverty, externalities of various kinds, monopoly, manipulation of consumer wants, sharp practice, resource depletion, and waste and inefficiency were all attributed to a failure of markets, or "pecuniary institutions" more generally, to control or direct economic activity in a manner consistent with the public interest.

The notion of an economics "relevant to the problem of control" (Hamilton 1919a) recurs repeatedly in the literature. This idea of "social control" as government intervention and regulation designed to guide the economy in socially desirable directions became a key part of the institutionalist creed (Everett, 1931).[8] The phrase "social control" became almost a mantra for the institutionalists of the time.

Whereas these elements and others provided common ground among institutionalists, there were differences between them, too: in the particular forms their empiricism took, in the extent to which they thought standard theory would have to be replaced (as opposed to supplemented), in the extent of their dissatisfaction with the market as an instrument of control, and in their specific proposals for reform and the degree of statism involved. The combination of scientism and reformism also created tensions that different individuals solved in different ways. Institutionalism did not consist of a well-defined "school" of economics, but as a *movement* held together by some fairly general methodological, theoretical, and ideological commitments.[9] Nevertheless, the movement can hardly be described as incoherent or without a positive program of its own.

The claim that interwar institutionalism was a part of the mainstream of economics leads directly to another argument, namely that institutionalism only later *became* a dissenting heterodoxy lying outside of the mainstream of American economics. As we move from the interwar to the post–World War II period, the marginalization of institutionalism occurred gradually in a process that coincided with the rise to dominance of neoclassical and Keynesian economics. These events are linked and are of obvious importance in the history of American economics. Understanding the relative decline of institutionalism is a necessary part of understanding the character of post-1945 American economics more generally. Here, my argument is that the story of institutionalism's relative decline is a complex one, involving a number of factors that together greatly weakened its appeal. A part of this story is that institutionalism increasingly came to be seen as insufficiently theoretical, but simply leaving the argument there fails to get to the heart of the matter. Institutionalists were certainly not enamored of the highly abstract and speculative nature of much neoclassical theory, but they

8 Helen Everett had been a student of Walton Hamilton's at the Brookings Graduate School.

9 This idea of institutionalism as an intellectual and sociological movement may have some connections to the concept of a "creative community." This concept has been explored recently at a conference at Duke University and will be the subject of a forthcoming special issue of *History of Political Economy*.

were not antitheoretical. They argued for a different conception of economic inquiry and theory. The standard view avoids the key question by implicitly adopting neoclassical criteria of theoretical adequacy. The real question is how and why such criteria came to dominate. Think for a moment about all the other social sciences, none of which developed in the same fashion as economics. Keep in mind, also, that Wesley Mitchell's research program as embodied in the NBER was based on an analogy with the physical sciences, and was one that had considerable respect, prestige, and Rockefeller Foundation funding. Indeed, in the interwar period it was the institutionalists, not the neoclassicals, who were most successfully claiming the mantle of modernism and "science" (Rutherford 1999). Somehow these positions reversed themselves.

PLAN OF THE WORK

This book seeks to give a detailed picture of institutionalism as an important part of American economics between the wars. This will involve not only a discussion of the ideas of institutionalists but a depiction of institutionalism as a movement – a network of people and institutional supports that occupied a significant place in the profession of economics. The primary focus will be on the years from 1918 to 1947, the years of institutionalism's greatest prominence and success, but events prior to and immediately after those dates will not be ignored. The discussion of the factors leading up to the development of institutionalism goes back to the 1880s and 1890s. There are treatments of developments somewhat beyond 1947 in a number of places, and the changing position of institutionalism in the post–World War II period is dealt with in Part Four of the book. Nevertheless, the primary focus is on the period between 1918 and 1947. I have chosen 1918 as the starting point because that was the year of Hamilton's original institutionalist manifesto. I have chosen 1947 as the end date because that was when the major universities resumed hiring after the Depression and World War II and conspicuously failed to hire institutionalists, indicating that an important change in academic status had occurred. It is also the date of the Cowles Commission's attack on the NBER (Koopmans 1947) and the date of the publication of Paul Samuelson's *Foundations of Economic Analysis* (Samuelson 1947).

Part One of this book, consisting of this chapter and the next, is intended to provide an introduction to the institutionalist movement. Most discussions of institutionalism focus on the ideas developed by a small number of key individuals including Thorstein Veblen, Wesley Mitchell, and John R. Commons. These three writers are usually presented as the three "founding fathers" of institutionalism, but that is not the way that the movement was represented at its beginning. Rather, that conventional conceptualization turns out, on examination, to be a later artifact, produced by commentators such as Joseph Dorfman (Dorfman 1959, 1963).[10]

The next chapter elaborates on many of the themes introduced earlier and provides an overview of interwar institutionalism. The first three sections of the chapter deal with the initial development and promotion of the idea of a definable institutional approach to economics that was undertaken between 1918 and 1927 by Walton Hamilton and others. The point will be to see who was involved in the initial promotion of the institutionalist idea, how they themselves defined the institutional approach, how they related themselves to the rest of the discipline, and the broader network of people involved and their institutional affiliations. All this involves focusing on how the promoters of the institutionalist movement constructed it *themselves*. The next two sections will discuss the background of institutionalism in terms of its sources and inspirations. Who were seen as the precursors and current contributors to the institutional approach? What role did Veblen play? What parts of the Veblenian canon were taken into institutionalism and which were not? To what extent did they draw on the ideas of the earlier generation of progressive-era economists such as R. T. Ely and H. C. Adams, and how did they differ from them? What factors led to the movement coalescing exactly when it did, in the period during and immediately after World War I? The last section will briefly sketch the content and contributions of interwar institutional economics. This involves indicating some of the

[10] Yonay (1998, pp. 71, 110) states that the term institutionalism "originally … was coined as a label to describe the work of Thorstein Veblen only," but he gives no reference or citation for this usage, and it is clearly not correct. Allan Gruchy's 1947 book restricts the use of the term "institutional economics" to Veblen on the grounds that it was *then* the standard usage, a claim that may be correct (Gruchy 1947, p. 4). Paul Homan in his "An Appraisal of Institutional Economics" (Homan 1932, p. 10) states that it is "the contention of Mr. Dorfman, Veblen's biographer, that Veblen alone may be properly classified under the category of institutional economics." Homan gives no citation for this statement about Dorfman. Dorfman's biography of Veblen did not appear until 1934, and the terms institutionalism or institutional economics do not appear in the index. In his *Economic Mind in American Civilization* (1959, p. 353), Dorfman mentions Hamilton's first published use of "institutional economics" and states that the term "institutionalism," referring to a movement, "gained wide currency in the 20s and 30s." He goes on to say that the roots of this movement reach farther back and that "the 'founding father' of the movement was Thorstein Veblen; and after him Wesley C. Mitchell and John R. Commons." In a slightly later essay on "The Background of Institutional Economics," Dorfman simply talks of "the three founders of institutionalism: Thorstein Veblen, John R. Commons, and Wesley C. Mitchell" (Dorfman 1963, p. 1).