

What was wrong with the old institutional economics (and what is still wrong with the new)?

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This paper is a comparison and critique of the old and the new institutional economics, with principal focus on the former. The paper argues that the old institutional economics (OIE) lacks methodological consistency and overall persuasiveness because of the preconceptions it took from the philosophy of pragmatism and its late nineteenth-century attitude towards science. The paper starts from the methodological problem posed by Thorstein Veblen; argues that the OIE was never able to solve that problem; and then poses a resolution of Veblen's dilemma in terms of a 'benchmark' programme useful in appraising both the OIE and the NIE. The paper also argues that the most appealing areas of OIE rhetoric – institutions and evolution – do not distinguish that programme from the NIE. What distinguishes the OIE are the less appealing doctrines of holism and instrumental valuing. The paper closes with a brief critique of the neoclassical core of the NIE.

I

In my editor's introduction to a 1986 collection of essays (Langlois, 1986a), I made the rather strong and controversial claim that, in the dim mists of modern economic theory, one could perceive the outlines of a 'new Institutional Economics' – and that the essays in the volume somehow fit together as representatives of that developing programme. In reviews that were otherwise quite kind, Coats (1986) and Mäki (1987) took me to task for these sweeping suggestions of programmatic unity. Moreover, they both chastised me a bit for a too hasty and somewhat distorted dismissal of the 'old Institutional Economics' of Veblen, Commons, *et al.* To all of these charges I must reluctantly plead guilty, or at least *nolo contendere*.

This essay is an attempt at redress. But it will not be entirely an act of humble penitence. Indeed, I propose to replace my hasty dismissal of the old institutionalists with a longer and more careful dismissal. On the issue of a new institutional economics I will be more contrite, for my reviewers were right in seeing my suggestions of programmatic unity as more hortatory than descriptive. But I will do little to correct that here, except to continue the exhortation in more critical tones.

I approach methodological criticism with some reluctance, as my own tastes are eclectic and my convictions pluralist. I tend to see methodology as the business of thinking clearly and making helpful distinctions.¹ But part of this task involves scrutinizing critically the methodological pronouncements and working practices of economists. As Bruce Caldwell (1982) suggests, we can examine a methodological system for internal consistency and success by its own lights. Does this programme make sense? Does it do what it set out to do? And, as Donald McCloskey (1985) insists, we can look at the rhetoric of economic writing. How do these economists attempt to persuade? How successful are they? It is in this spirit that I propose to approach the old institutional economics (OIE).

My thesis is that the OIE – or one central tradition within the OIE, at any rate – fails from the point of view both of internal coherence and of overall persuasiveness. Indeed, these failures are related.

II

In order to paint the OIE with a suitably fine brush, I will concentrate on the work of Thorstein Veblen and certain writers he inspired, notably Clarence Ayres and his present-day followers.² Convenience aside, there is good reason to focus on Veblen. His early methodological writings are arguably the central wellspring of OIE thought. More importantly, the methodological issues Veblen framed in those essays provide common ground between the two versions of institutionalism, and a useful framework for comparing them.

Of course, there is also danger in focusing on the work of this inveterate ironist and prankster. Even at his most serious – as in his early methodological writings – Veblen is often playing games with the reader. One may well argue, for example, that Veblen's writings in this period were more an attempt to provoke the establishment than to construct a consistent methodological alternative. In the end, however, the result is the same: Veblen failed to resolve the methodological dilemma he posed so clearly.

In his famous 1898 essay, Veblen assails economics for not being a truly evolutionary science, 'a genetic account of the economic life process'. (Veblen, 1898; 1919: 72). For this reason classical economics is merely 'taxonomic', prescientific. The German historical school, he thinks, does see economics as process of development; '. . . but they have followed the lines of pre-Darwinian speculations on development rather than the lines

¹ As a paradigm of this, I offer Machlup (1936).

² This will mean leaving aside other important writers and traditions within the OIE, of course. I will have a little to say about John R. Commons, whom I view as quite different in approach from Veblen and whom I see as the OIE writer most congenial to the NIE. But I will have to ignore Wesley C. Mitchell and others completely.

which modern science would recognize as evolutionary. They have given a narrative survey of phenomena, not a genetic account of an unfolding process.' Marginalist neoclassicism – which, interestingly enough, he identifies with Carl Menger and the Austrian school – has created a suitable genetic theory; but 'the Austrians have on the whole showed themselves unable to break with the classical tradition that economics is a taxonomic science.' The reason? Neoclassicism operates, he feels, with a faulty conception of human nature. To illustrate, he treats us to the following wonderful and oft-quoted passage:

The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. Self-imposed in elemental space, he spins symmetrically about his own spiritual axis until the parallelogram of forces bears down upon him, whereupon he follows the line of the resultant. When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before. Spiritually, the hedonistic man is not a prime mover (Veblen, 1919: 73).

The problem with neoclassicism thus seems to be that it labours under an outmoded hedonist psychology, a Newtonian conception in which the economic agent is but inert matter under the sway of forces.

At this level, Veblen's attack on neoclassicism is both clever and persuasive. Although he is quite unfair both to classical economics and to Menger (more on this below), it is certainly true that Jevons saw marginalism in the light of Benthamite utilitarianism. And there might be good reasons to reject such a formulation. That economics should be oriented toward process – maybe even Darwinian process; that economics should embrace different and wider conceptions of human behaviour and motivation; that economics should not cling mindlessly to outmoded conceptions of science: these are all propositions with considerable appeal.³

The problem comes when we ask what Veblen would substitute for the outmoded hedonism he saw in neoclassical economics. To complain that the hedonistic agent 'is not a prime mover' would certainly seem to suggest that Veblen is calling for a more humanistic conception, one in which the consciousness of the agent plays a more important role. In fact, however, Veblen is calling for quite the opposite. What makes a theory scientific in the modern (i.e., late nineteenth-century) scheme of things is that it *eliminates consciousness completely* as an explanatory element. Modern science, says Veblen, relies on explanations from 'efficient cause' rather than explanations from 'sufficient reason'.

³ Propositions, one might add, that animate the NIE as much as the OIE.

Barring mystical or providential elements, the relation of sufficient reason runs by way of the interested discrimination, the forethought, of an agent who takes thought of the future and guides his present activity by regard for this future. The relation of sufficient reason runs only from the (apprehended) future into the present, and is solely of an intellectual, subjective, personal, teleological character and force. The modern scheme of knowledge, on the whole, rests, for its definitive ground, on the relation of cause and effect; the relation of sufficient reason being admitted only provisionally and as a proximate factor in the analysis, always with the unambiguous reservation that the analysis must ultimately come to rest in terms of cause and effect (Veblen, 1909; 1919: 237).

The problem, then, is not that the hedonist globule of desire is too mechanical and inhuman; the problem is that economic explanation is too human and insufficiently mechanical.

The model here, of course, is evolutionary biology. Darwinian theory had superseded the animism of the argument from design; the teleology of pre-Darwinian theories of evolution (e.g., those of Erasmus Darwin, Charles Darwin's grandfather); and the 'taxonomic bent' of Linnaean classification. In their place it had left a fully materialistic explanation in terms of 'opaque cause and effect': evolution has no course, and no consciousness guides it – or even affects it. Veblen clearly wants to translate this idea into economics. Taken to its logical conclusion, of course, that would mean eliminating all consciousness from economic explanation, creating an economic analogue of Skinnerian behaviourism. Veblen recognizes the danger, but skates ahead anyway.

Now, it happens that the relation of sufficient reason enters very substantially into human conduct. It is this element of discriminating forethought that distinguishes human conduct from brute behavior. And since the economist's subject of inquiry is this human conduct, that relation necessarily comes in for a large share of his attention in any theoretical formulation of economic phenomena, whether hedonistic or otherwise. But while modern science at large has made the causal relation the sole ultimate ground of theoretical formulation; and while the other sciences that deal with human life admit the relation of sufficient reason as a proximate, supplementary, or intermediate ground, subsidiary, and subservient to the argument from cause and effect; economics has had the misfortune – as seen from the scientific point of view – to let the former supplant the latter. (Veblen, 1909; 1919: 238).

Read at the level of platitude, this passage is unobjectionable: economics must pay attention both to sufficient reason and to efficient cause. But read more carefully, the passage suggests that sufficient reason and efficient cause are by no means equal in Veblen's affections. He does not view human consciousness as a vital element that must fit into any system of economic theory; rather, he views human consciousness as a troublesome anachronism whose role any genuinely 'scientific' economics must minimize and, should it ever prove possible, ultimately eliminate.

Such a goal, it seems to me, is necessarily illusory. A programme that

would reduce social science to 'objective' facts and observable relationships is unlikely to succeed when the 'facts' are themselves necessarily the product of human cognition.⁴ Human beings do not live in a world of raw fact; they live in an interpreted world, a world in which objects, actions, and relationships have meaning. As a consequence, a scientific explanation involving humans must take those meanings into account, since they are necessarily part of the 'facts' available. In this sense, social science must be partly interpretive or, to use a fancy word, hermeneutic. To make this argument properly, of course, would require a far longer discussion than is appropriate here.⁵ Moreover, the late twentieth century is far more inclined than the late nineteenth (or even the early twentieth) to think in these terms, and a longer discussion would risk preaching to the converted.

The method of sufficient reason provides useful information about economic phenomena. If people act, if they pursue goals, if they follow certain rules or conventions, then this information provides a richer explanation of the phenomena under study. This human action will not by itself explain the phenomena; that is, the goals etc., of the agents will seldom translate into the 'goals' or 'purposes' of the economic phenomena in the aggregate. Some elements of 'efficient cause' will also necessarily enter into the explanation.⁶ Veblen's claim is that hedonist marginalism relies exclusively on sufficient reason, and therefore creates a picture of the economy that is too rational, too purposive, too full of human intention. Perhaps. But what is certainly true is that the opposite error – too little sufficient reason – creates a dispirited, lifeless picture of economic phenomena.

We can see this in the contrast between Veblen's own picture of the economy and the one he imputes to Adam Smith. In his second essay on 'The preconceptions of economic science' (1899), Veblen works very hard to portray Smith's system as imbued with an 'optimistic animism'. Old Adam is a crafty devil, it turns out, and Veblen is forced to admit that 'Smith's animistic bent asserts itself more plainly and more effectually in the general trend and aim of his discussion than in the details of theory' (Veblen, 1919: 114). The problem seems to be Smith's belief that a particular institutional system, what he called the System of Natural Liberty (consisting of decentralized rights in common law rather than central administration), has desirable properties. Surely, says Veblen, Smith does not mean that this system is 'natural' in the sense of necessary,

⁴ In fact, there is a sense in which a social science that completely eschews sufficient reason is impossible. By this I do not mean that one cannot attempt such a reduction; rather, I mean that the attempt leads to distorted and self-handicapped theory. Moreover, the theory that results does not eliminate 'anthropomorphic' or 'teleological' elements at all: it merely introduces them in a different, and far more dubious, way.

⁵ But see Hayek (1948: Chapter 3; 1979: Chapter 3) for a careful critique of behaviourist social science along these lines.

⁶ I am being intentionally vague here. But I plan to make this all more precise in the next section.

else why all the complaint about the Mercantile System? By 'natural', then, Smith must mean that this system of institutions stands outside the cumulative cause and effect of history as if ordained by God. 'When things have gone wrong', says Veblen of Smith's system, 'they will right themselves if interference with the natural course ceases; whereas, in the case of a causal sequence simply, the mere cessation of interference will not leave the outcome the same as if no interference had taken place. This recuperative power of nature is of an extra-mechanical character' (1919: 116).

Now, this is a serious mischaracterization of Smith's enterprise; but it is interesting not for what it says about Smith's world-view but for what it says about Veblen's. Unlike the physiocrats, Smith had no Cartesian conception of a 'natural order' to which the economy would snap back once 'interference' ceased; rather, he was performing what we would now call a comparative-institutional analysis of mercantilism and *laissez faire*. The only 'extra-mechanical elements' are the self-interested actions of individuals, though it is indeed in part these elements in Smith's theory that give the System of Natural Liberty its desirable properties. If, as Veblen urges, we remove these human elements from the theory, then we are indeed left with only blind 'cumulative causation'; and any cohesion in the economic system would have to come from outside the theory. But this is Veblen's methodological preconception, not Smith's. One may wish to criticize Smith's theory; but his institutional assessment is an artifact of that theory, not of any rose-coloured glasses. Indeed, the problem is not that Smith had an 'animistic and optimistic bent' but that Veblen had the opposite preconception – a kind of pessimistic materialism – growing out of his effort to eliminate human purpose and intention from his picture of the economy. Veblen's was the pessimism of 'opaque cause and effect'.

It is by no means a far-fetched interpretation of the textual evidence, especially in these early methodological writings, to construe Veblen as a proponent of a behaviourist social science. No less a figure than John R. Commons (1934: 654) saw him exactly this way.⁷ Nevertheless, I think the situation is more complex. Although this pessimistic materialism did clearly colour Veblen's overall view of the economic system, he was never actually willing or able in practice to carry this position to its logical conclusion. Veblen's own theorizing is not always consistent with an insistence on 'objective' science. At times – especially in later works such as *The engineers and the price system* – we can taste the strong flavour of a pessimistic materialism. But in the *Theory of the leisure class*, for example, his portrayal of individual behaviour and motives would likely please the most demanding present-day proponents of interpretive method. Indeed, Veblen's famous notion of 'instincts' actually has much more in common with the Smithian 'propensities' he ridiculed than it does with Skinnerian psychology or Darwinian biology. The point is not that Veblen chose

⁷ For a defence of Veblen against Commons, see Mitchell (1937: 333n).

efficient cause over sufficient reason; rather the point is that he never found a way to unite the two into a consistent methodological scheme.

Both David Seckler (1975) and Philip Mirowski (1987) have produced interpretations of Veblen very much along these lines. In both cases, much of the blame for this tension in Veblen falls at the feet of pragmatic philosophy and the attitude toward science it implied. Mirowski, for example, argues that the original direction of pragmatism, in the hands of C.S. Peirce, was decidedly not towards an 'objective', nonhuman view of science. The inventor of semiotics, Peirce was committed to the hermeneutic approach. But John Dewey and William James misunderstood Peirce's original conception, distorting it in distinctly scientific directions. And it was the pragmatism of Dewey and James – not that of Peirce – that influenced Veblen. Had he followed Peirce instead of Dewey, he might have seen a way to integrate sufficient reason with efficient cause. 'Yet', says Mirowski, 'this was not the road taken by Veblen's subsequent intellectual career. Instead, he tended toward an increasingly pessimistic Manichaeism with sufficient reason as the darkness and efficient cause, now conflated with Peirce's pragmatic maxim, as the light.' (Mirowski, 1987: 1022.)

Although Veblen did not take efficient cause to its logical conclusions, others, inspired by Veblen, did just that. In particular, it was Clarence Ayres who picked up and ran with the most stoutly behaviourist side of Veblen's methodology. (Seckler, 1975: 68–74; Mirowski, 1987: 1029–30.) The Ayresian influence, which seems to dominate the present generation of OIE writers, shines through clearly in several important recent attempts to synthesize a unified institutionalist programme.⁸ Looking carefully at Veblen's methodology has helped outline an answer to the question posed in this essay's title. To answer the question completely, we will need to look in some detail at this present-day OIE programme.

Before doing that, however, we need a benchmark. To put it another way, we need to ask how we might actually begin solving Veblen's dilemma.

III

The methodological problem remains: how to find a balance of – or perhaps a third way between – sufficient reason and efficient cause.

Mirowski thinks that the OIE tradition can be mobilized to 'participate in the reconstruction of economic theory from a hermeneutic perspective' if only its practitioners would discover the missed Peircian connection. There

⁸ See especially Gruchy (1987) and the symposium in the September, 1987 issue of the *Journal of Economic Issues*. Gruchy (1972: 16) lists Ayres among a group he calls 'neo-institutionalists', and others (e.g., Jensen, 1987: 1053) go so far as to identify this neo-institutionalism with Ayres's views. But since Gruchy includes such diverse characters as Galbraith and Myrdal under this rubric, and since Ayres is so clearly in the tradition of Veblen, I see no need for this confusing distinction in discussing the present-day OIE.

is no doubt Peirce has much to teach us. But it seems distinctly odd to advocate building an interpretive economics on the foundation of the OIE after demonstrating that Peirce had almost *no influence* on that tradition. Veblen (and Commons) may have used hermeneutic (or other interpretive) techniques in some of their substantive work; but what systematic methodological writing there is in the OIE points in a quite different – or at best an ambiguous – direction. If one is looking for a foundation on which to construct an interpretive economics, why not look to traditions in which interpretive methods have had a long history and an honoured place?

Consider Adam Smith, for example. Although Veblen's peculiar methodological spectacles prevented him from seeing it, Smith and his compatriots in the Scottish Enlightenment had grappled with – and partly solved – the very problem that so vexed Veblen. Far from providing an animistic or teleological explanation for aggregate economic phenomena, Smith had actually argued for the inadequacy of teleological explanation. His innovation – and that of his Scottish colleagues – was to add elements of efficient cause to the method of sufficient reason. The idea of the invisible hand itself illustrates this. There is, first of all, the teleological element: each person pursues his or her own self-interest. This is the method of sufficient reason, the interpretive element, constructed by placing oneself in the shoes of the individual. But the goals or motives of the individual do not translate into the aggregate level. Indeed, the aggregate outcome is different from – or even opposite to – individual intention. The individual is ‘. . . led by an *invisible hand* to promote an end which is no part of his intention’ (Smith, 1976: 456, original emphasis). What redirects individual intention is the element of efficient cause: there is something structural and systematic about the interaction of individual intentions that channels behaviour and produces the (surprising) aggregate outcome.

Another way to see this is to recognize that the Scots set out on the road to an evolutionary economics more than a century before Veblen asked them to.⁹ Indeed, it is now generally recognized that Charles Darwin was inspired by the ideas of ‘spontaneous order’ worked out by the Scots.¹⁰ (Jones, 1986; Schweber, 1977.) The latter were interested in social rather than natural phenomena, of course; and, unencumbered by nineteenth-century attitudes about ‘objective’ science, they felt no need to eliminate sufficient reason from their scheme. Their goal was to explain social phenomena (including social institutions) as, in Adam Ferguson's famous phrase, ‘the results of human action, but not the execution of any human

⁹ In his *Dialogues concerning natural religion*, written (though not published) exactly 100 years before *The origin of the species* appeared, David Hume actually articulated the idea of natural selection as a potential objection to the argument from design.

¹⁰ This more recent scholarship supplants the older view that Darwin's influence from social science consisted entirely of Malthus.

design'.¹¹ (Ferguson, 1767; 1980: 187). It is important to notice how this approach resolves Veblen's dilemma, how it frees one from the Manichaeistic alternatives of teleology and cumulative causation.

Veblen's dichotomy of sufficient reason and efficient cause reflects an older dichotomy, going back to the Greeks, between what is 'artificial' and what is 'natural'. To say that something is artificial is to use sufficient reason: to explain it as (consciously) created by human will. To say that something is natural is to use efficient cause: to explain it as the result of physical laws and causes. As F.A. Hayek has long argued,¹² the Scottish innovation was to carve out a third way between these alternatives. A wide range of social phenomena – including most social institutions – are neither artificial nor natural in these senses. Veblen's methodological colour blindness prevented him from seeing this third alternative.

What gives the situation a wry twist, of course, is that it was Carl Menger – one of Veblen's primary targets – who most clearly and forcefully developed the Scottish legacy in the nineteenth century.

Menger is best remembered as one of the 'marginalist revolutionaries'; and he was indeed a codeveloper of many of the ideas of marginal-value theory. But, as recent scholarship has emphasized, Menger's approach was quite different from those of Jevons and Walras. (Streissler, 1973; Jaffé, 1976). Influenced by Aristotle and Kant rather than by Bentham, Menger was not at all a hedonist.¹³ He saw marginalism as flowing not from individual psychology but from the logical problem of allocation attendant on scarcity. To put it in modern terms, Menger adumbrated the method of 'situational analysis', a notion to which I'll return presently. As Jaffe (1976: 521) rightly put it, 'Thorstein Veblen's strictures upon what he considered the Austrian preconception of human nature fit Jevon's or Walras's theory much better than they do Menger's.'

It is when we turn to the issue of social institutions, of course, that the irony of Veblen's attack on Menger is most sharp. For, next to marginalism itself, Menger's greatest contribution to economics was the economic theory of social institutions. In 1883, Menger published a treatise attacking the methods of the German historical school. That school argued, in part, that the multiplicity of social institutions in different times and societies rendered theoretical generalization impossible, calling instead for piecemeal historical studies. Menger's line of attack was not to deny the importance of social institutions but, as Ludwig Lachmann puts it, 'to turn the flank of his enemy's position by a bold move' (Lachmann, 1971: 56). He distinguished

¹¹ For an excellent account of the theory of spontaneous order in the Scottish Enlightenment, see Hamowy (1987).

¹² E.g., Hayek (1967: Chapter 6).

¹³ McCulloch (1977) has argued that Menger's formulation of utility anticipated the antipsychological twentieth-century conceptions of Pareto and Hicks and was, in fact, 'intrinsically ordinal' in a technical sense.

between 'pragmatic' institutions and 'organic' institutions. The former are the product of conscious design and legislative fiat; the latter are not. These 'organic' institutions do not invalidate theoretical inquiry but actually cry out for theoretical analysis. 'How can it be', Menger wrote in a famous passage, 'that institutions which serve the common welfare and are extremely significant for its development come into being without a *common will* directed toward establishing them?' (Menger, 1963: 146, original emphasis). This, he added, is 'perhaps the most noteworthy problem of the social sciences' (1963: 146). Thus could Menger claim that it was actually the historical school who misunderstood and neglected the true nature and importance of institutions.

Like Veblen, Menger saw the importance of ridding social theory of unwarranted teleological elements. Organic institutions – like money, language, much of common law – grew up in society without anyone having designed them for a conscious purpose. But, unlike Veblen, Menger did not see such institutions as the product of blind cumulative causation alone. For Menger, social institutions evolve through the interactions of individuals pursuing their own interests: teleological elements at the *individual* level provide some of the causal elements. Organic institutions:

. . . as a rule are not the result of socially teleological causes, but the unintended result of innumerable efforts of economic subjects pursuing individual interests. The theoretical understanding of them, the theoretical understanding of their nature and movement can thus be attained in exact manner only . . . by reducing them to their elements, to the individual factors of their causation, and by investigating the laws by which the complicated phenomena of human economy under discussion here are built up from these elements. (Menger, 1963: 158-59).

This is what Menger called the 'compositive' method, an obvious and conscious elaboration of the approach of the Scottish enlightenment. Menger's own most famous use of this method is in his evolutionary theory of money (O'Driscoll, 1986), which he first suggested as early as the marginalist treatise of 1871 (Menger, 1981).

Although Menger clearly used a form of situational analysis, he tended – perhaps under the rhetorical pressures of the *Methodenstreit* – to portray situational determinism as genuine determinism. He argued that, barring error and extraneous influences of various sorts, human conduct is quite literally determined by conditions of needs and scarcity. This, he believed, allows for the possibility of 'exact laws' in the social sciences (Menger, 1963: 216-19). As Lachmann (1971) points out, this quest for rigid determinism is wholly unnecessary to Menger's theoretical enterprise. It is possible to understand this compositive method in interpretive – hermeneutic – terms. And for Lachmann, as for many others, the clues to this reconstruction of Menger's approach are to be found in the work of Max Weber:

Weber denied Menger's contention that the 'laws' governing economic conduct (among which was Menger's own creation, the law of marginal utility) are 'exact laws' in the same sense as those found in nature. He regarded this as a 'naturalistic fallacy'. He insisted that the observable uniformity of human conduct in economics, profit maximization in business etc. is essentially of a 'pragmatic' nature and has nothing whatever to do with 'psychology' of any kind. Once a man decided to conduct his business with the aim to maximize his profits, certain necessary consequences followed, but such necessity was of a strictly conditional nature, and its source was 'pragmatic' in the sense that it lay in the 'logic of the situation' the businessman confronted. In fact, abstract economic theory consisted essentially of rational schemes in which the conditions of successful action were defined in such a way as to require certain kinds of action. This is something very different from the way in which natural events are 'determined' by their causes. The naturalistic fallacy consists in confusing the two. (Lachmann, 1971: 25-26).

We can think of this method of situational analysis as, broadly speaking, an attempt to grapple with the problem posed for theory by free will. Since humans have free will, their conduct is indeterminate; but theory demands determinateness: assumptions must lead to conclusions. Situational analysis compromises by creating this kind of 'conditional' determinateness. We create a situation for the human agent in which there is only one plausible or reasonable – or 'rational' – course of action. We create, as Latsis (1976) puts it, a single-exit model. This technique is very much an interpretive enterprise. To create the situation, we must place ourselves in the shoes of the agent. And this involves the technique of understanding or *Verstehen*.

It was Alfred Schutz, the Austrian philosopher and sociologist, who developed Weber's approach most clearly and forcefully as a method applicable to economics.¹⁴ For Schutz as for Weber, the method of situational analysis was animated by the construction of an ideal type, a simplified theoretical artifact that would help explain a more complex reality. In Schutz's version, one constructed ideal types with varying degrees of 'anonymity' according to the uses to which the device would be put: historical analysis called for very detailed and less anonymous types, whereas the most general theory called for highly abstract or anonymous types. For example, explaining the behaviour of the Federal Reserve Board in 1929 might require a fairly detailed ideal type of the central banker; but analysing the response of wheat prices to a poor crop would require only a very abstract – anonymous – ideal type of the wheat farmer or consumer. The latter analysis would, as a result, be much more generally applicable (Machlup, 1936).

To Schutz, the ideal type is a kind of preprogrammed puppet. Which puppet – which level of anonymity – we choose depends, for Schutz, on the

¹⁴ In addition to Schutz (1967), see Machlup (1978: Part 4), Langlois and Koppl (1984), and Prendergast (1986).

kind of problem we are analysing. But what exactly *is* it about a problem that dictates a more or less anonymous type? The answer lies in the nature of the situation the hypothetical agent is facing. An agent (like the wheat farmer) who is greatly constrained by external circumstances has few (possibly only one) available course of action. We thus need to know little about what would influence the choices of that agent, and the appropriate ideal type is quite an anonymous one. On the other hand, an agent less constrained by circumstances, who has many more reasonable courses of action, requires a much more detailed characterization. We would need to know a good deal more about the psychology and motivation of the central banker than of the wheat farmer. Thus it is this press of circumstances – what I call the ‘system constraint’ (Langlois and Koppl, 1984; Langlois, 1986b) – that dictates the level of anonymity of the ideal type.

What is this ‘system constraint’?¹⁵ There are, I think, two aspects to it. At one level, the system constraint involves whatever makes up the agent’s situation. In one formulation – arguably characteristic of much of neoclassical economics, especially Walrasian general-equilibrium theory – the elements that go into the agent’s situation are solely ‘natural’ givens like resource endowments; and the situational analysis in this formulation reduces to such natural givens and the psychological states of the agent. A programme taking this approach would be guilty of what Agassi (1975) calls ‘psychologism’. By contrast, one could imagine the agent’s situation as comprising not only natural givens but also unreduced social artifacts like rules, conventions, and institutions of various kinds. A situational analysis permitting this possibility would reflect what Agassi calls ‘institutionalism’. (We should not confuse Agassi’s institutionalism with the new and old institutionalism, even though, as I will argue below, the former is a necessary but not sufficient element of the latter). The system constraint, then, is partly the constraint imposed on the agent by social institutions – the influence of those institutions on the situation the agent is portrayed as facing.

But there is another aspect to this system constraint. If, as Smith and Menger argue, a principal goal of social theory is to explain phenomena that are the unintended result of individual action, then the conclusions or output of a theory cannot follow directly from what is intended by the agents individually.¹⁶ To put it another (and more formal) way, we cannot derive theoretical propositions about aggregate phenomena directly from statements about individual behaviour: we also need propositions about how the individual behaviour links up or ties together to form the aggregate

¹⁵ I discuss the following issues more carefully in Langlois (1986b).

¹⁶ Mäki (1988) has constructed an argument along similar lines. He shows that the method of situational analysis (specifically, the hermeneutical method of G.H. von Wright’s ‘practical syllogism’) cannot by itself generate invisible-hand processes like those implied in Menger’s theory of money.

result. In short, we need a compositional principle. And this compositional principle – or rather the interaction among individual agents that it implies – must be part of the system constraint that limits the agent's discretion.

Even the 'rational maximization' models of neoclassical economics have a compositional principle, although it is normally kept in the shadows. For example, individual demand functions (which result from individual utility maximization) must be added up to form market demand: addition in this (simple) case is the compositional principle. In a full-fledged model, there is typically more both to the compositional principle and to the system constraint: for instance, the basic model of neoclassical microeconomics also appeals to the notions of equilibrium and competition, elements that are not directly contained in the choice problem the agent faces but that nonetheless affect the agent's situation in the larger sense. It is these elements in combination, not 'rationality' alone, that lead to determinate results (Arrow, 1987: 203).

The neoclassical model of the agent's situation¹⁷ and the neoclassical compositional principle do not, of course, exhaust the possible situational analyses or compositional principles one could apply. Indeed, a large part of what it might mean to make economics a more 'evolutionary science' is precisely to use an alternate compositional principle akin to the one implicit in Darwinian biology. This is not a new idea (see Alchian, 1950; Winter, 1964; Nelson and Winter, 1982). It is in many ways what the Smith-Menger tradition was up to. Indeed, the notion of an 'invisible hand' compositional principle is actually much more general and sophisticated than an 'evolutionary' principle modelled on biology (Ullmann-Margalit, 1978; Elster, 1983; Langlois, 1986b).

Let's take stock. I have argued in this section that there exists a methodological alternative that resolves a dilemma that, misled by late nineteenth-century attitudes toward science, Veblen posed but was unable to solve. This alternative incorporates elements both of 'sufficient reason' – in the form of situational analysis – and of 'efficient cause' – in the form of invisible-hand compositional principles. Moreover, this alternative is interpretive but not psychologistic. It is an institutionalist programme in two senses: 1) it considers the effect of institutions on individual agents by incorporating such institutions as part of situation the agent is portrayed as facing;¹⁸ and 2) it envisages social institutions as important among the

¹⁷ There is, in fact, some question as to whether the neoclassical programme is ultimately situational determinism at all. Latsis (1976) contends that it is; but I wonder whether it might not just as easily be considered behaviouralism (in the sense of Herbert Simon) with a (perhaps implausible) behavioural postulate behind it (Langlois, 1986b: 233). Is it really appealing to the 'logic of the situation' to portray the agent as solving a complex optimal-control problem with a foot-long objective function?

¹⁸ That is, it embraces Agassi's programme of institutional individualism.

phenomena it seeks to explain, typically analysing them as the unintended results of individual action.¹⁹ I also argued that this approach resides in (can be constructed out of) a tradition of writers normally considered antagonists to the OIE.

It is this programme that I offered as a basis for the new institutional economics (Langlois, 1986b, 252–53). My purpose here is not to criticize or elaborate on this scheme; rather, I propose to use it as a kind of benchmark against which to appraise both the present-day OIE and the developing NIE.

IV

So, what *was* (or rather *is*) wrong with the OIE?

Part of the answer is that there is *nothing* wrong with some aspects of the OIE viewpoint. Some elements of the OIE programme are consistent – at a very broad level – with elements of the benchmark programme. But other aspects of the OIE viewpoint are entirely *inconsistent* with the institutionalist programme I've suggested. These elements are what is wrong with the OIE. For future reference, let me designate as Group 1 elements those aspects of the OIE programme that are broadly consistent with the benchmark programme and as Group 2 elements those aspects inconsistent with (or at best irrelevant to) benchmark institutionalism.

I contend that the aspects of the OIE that are most appealing and persuasive – those aspects that are most genuinely 'institutionalist' – are in fact the parts of the OIE programme broadly consistent with the benchmark. Those aspects of the OIE programme that are most dubious and least persuasive are those inconsistent with the benchmark programme. Moreover, these Group 2 elements are the direct result of the failure to resolve Veblen's methodological dilemma in a consistent and humanistic way.

The following four-part schema captures, I think, a fair representation of the present-day OIE programme as articulated by its proponents:

- Group 1
 - a) Evolution or process.
 - b) Culture and institutions.
- Group 2
 - a) Methodological holism
 - b) Instrumental valuing.

Let us examine these in order:

¹⁹ That is, it embraces the programme of Smith and Menger.

1 Group 1: a) Evolution or process

This element of the programme is quite straightforward in light of the foregoing discussion, and little need be said. The importance of casting theory in terms of processes – including evolutionary ones – has long been a fixture of OIE rhetoric. And, as I have argued, it is also a crucial feature of the Smith-Menger tradition from which I have constructed the benchmark programme. Consider, indeed, Malcolm Rutherford's description of one particular economist, whose '... concern was that the full complexity of the system of institutions and the way in which it bears on individual behavior should be taken into account; and that attention should be directed to the unintended consequences, particularly the unintended aggregate or social consequences, of behavior patterns induced by the institutional system taken as a whole' (Rutherford, 1987: 66). Who is this economist? It turns out to be Wesley C. Mitchell. But it could as easily have been Smith, Menger, or Hayek.²⁰

2 Group 1: b) Culture and institutions

Here again little need be said. The influence of culture and institutions on individual behaviour has also been an important pillar of OIE rhetoric. And the thrust of the preceding section has been to argue that such influence is also important to the benchmark programme and its antecedents. Let me again illustrate with a quotation, this time from Allan Gruchy: 'Veblen's theory of culture moves,' he says, 'along the following lines. Man is a self-active creature who seeks to satisfy his instinctive drives by using his reason and following customary and habitual ways of behaving. These ways of behaving give rise to institutions which are the key elements of human culture. Institutions develop over time as aids by means of which men organize and control individual and social behavior in order to satisfy their wants.' With some charitable reading of the meaning of the term 'instincts', this could just as easily describe Hayek's theory of culture (Vanberg, 1986). Or Schumpeter's. Schumpeter was also very much a part of the tradition I associate with the benchmark programme (Langlois, 1985; 1987). And, in works like *Imperialism, Social classes, and Capitalism, socialism, and democracy*, Schumpeter constructs a theory of the effect of institutions and cultural values on economic and political behaviour – and of economic and political behaviour on institutions and cultural values – that certainly rivals Veblen in range, boldness, and originality.²¹

²⁰ Rutherford (1987: 71) is in fact aware that Hayek holds similar views. He is one of very few students of the OIE who is so aware.

²¹ Moreover, one could argue that, Veblen to the contrary notwithstanding, the only place in *any* economic theory where one can find an agent who is genuinely a prime mover is in Schumpeter's theory of the entrepreneur (Schumpeter, 1934) and in the related theory of Israel Kirzner (1973).

3 Group 2: a) Methodological holism

The issue of holism versus individualism is, of course, one of the most hoary and tangled of the social sciences. I do not want to jump full into this debate; rather, I want to suggest that the issues relevant here are not the ones one might normally think they are.

The OIE view of methodological holism starts from the observation that individuals do not live in isolation but are influenced by the society in which they live. Interpreting methodological individualism to be the doctrine that theory must treat individuals as if they were (to repeat Veblen's phrase) isolated, definitive human data with no social influence, proponents of the OIE assert that theory must instead deal with various societies and collectivities 'as a whole'. Perhaps. But this sort of cant misses the important issues.

Consider Gruchy's discussion:

All cultural systems are holistic in nature. This means that a cultural system, whether it be a total society or a total economic system, is made up of a number of parts that together constitute the whole or totality of the societal or cultural system. The culturalist methodology emphasizes that much of the significance of a part of the cultural whole is derived from an understanding of the nature of this whole, just as the significance of this whole is grasped by relating it to the many parts that make it up. (Gruchy, 1987: 42.)

This certainly sounds like a staunch holist position. It is not. Not at this level of generality, at any rate. In fact, nothing in this passage need be inconsistent with methodological individualism. As Agassi (1975) explains, there is nothing in individualism that is necessarily opposed to seeing social wholes as 'more than the sum of the parts'²²; to believing that 'society' affects individual aims and purposes; or to maintaining that social institutions of various sorts constrain individual behaviour. These concerns come into conflict with the individualist position only when one makes the further assertion that 'if "wholes" exist *then* they have distinct aims and interests of their own' (Agassi, 1975: 147, original emphasis). That is to say, what is distinctive about holism is only the claim that wholes are a sufficient level of analysis – that one need not build up wholes from individuals and refer back to individuals – and that such wholes possess human-like properties of intention and motivation. This claim Gruchy does not seem to be making.

²² And methodological individualists have long recognized this. Consider this pronouncement by F.A. Hayek, among the staunchest proponents of this doctrine. 'The overall order of a group is in two respects more than the totality of regularities observable in the actions of the individuals and cannot be wholly reduced to them. It is not so only in the trivial sense in which a whole is more than the mere *sum* of its parts but presupposes also that these elements are related to each other in a particular manner. It is more also because the existence of those relations which are essential for the existence of the whole cannot be accounted for wholly by the interaction of the parts but only by their interaction with an outside world both of the individual parts and the whole' (Hayek, 1967: 70–71, original emphasis).

The individualist's distrust of assigning purpose to wholes is often thought to be ontological in origin: such 'wholes' do not exist independently of people, and only people have purposes. This is certainly true. But the real argument is actually epistemological. To treat wholes as having purpose and other human characteristics is to throw away valuable information.²³ Human motivation is something we know a bit about, being humans ourselves. To say that collectivities have such characteristics may be a useful metaphor at times; but the 'motives' of wholes is not something to which we have very easy epistemological access. We should not let the metaphor blind us to the information to be gained by looking at the behaviour of the individuals whom the collectivity comprises.²⁴ Indeed, if we can criticize the level of the individual it is not for being too atomistic but for being *too holistic*. Following writers like Schelling (1984) and Elster (1979), we might consider unpacking the metaphor of the individual and examining even 'lower' levels of aggregation.

Am I saying, then, that there is no difference between the OIE and the benchmark programme on this issue – that proponents of the OIE are institutional individualists in Agassi's sense? Some OIE writers may in fact be largely in agreement with the NIE on the issue.²⁵ And even the passage from Gruchy cited above – when read at the level of platitude, at any rate – seems entirely unobjectionable. But there is also certainly evidence that the OIE is quite willing to impute purpose and intention to social wholes without being very careful about the way these are built up from individual action and intention. Let me focus here on the views of John R. Commons, whom I have so far ignored. We turn again to Gruchy:

His [Commons's] collective economics stresses the dynamic and purposive qualities of an economic system based upon uncertain expectations relating to future production and consumption. Commons's economics emphasizes the fact that the dynamic American economy is open not only to the possibility of great risks and hardships for many participating individuals, but also to the possibility of continuously improving the living standards of the masses. Commons emphasizes the importance of the collective efforts of the nation to

²³ For an elaboration of this point, see Phillips (1976) and Langlois (1983a; 1983b).

²⁴ Perhaps a concrete example would make this clearer. Consider Graham Allison's well-known analysis of the Cuban missile crisis (Allison, 1971). His innovation was to stop seeing the behaviour of the USA and USSR as reflecting a rational national interest managed and articulated by national leaders. Instead, he pointed out the key roles of individuals at all levels of the complex bureaucracies, all operating with their own interests and limited knowledge. Holism would have urged some kind of 'national interest' analysis; but that would have led to misleading – perhaps dangerously misleading – conclusions.

²⁵ Geoffrey Hodgson is one student of institutionalism sympathetic to the OIE who seems to agree that Agassi's notion is indeed appropriate. His principal complaint seems to be that Agassi (and others) have rhetorically appropriated this conception to individualism. '[W]hy is theirs an "individualist" rather than (say) an "institutionalist" methodology?' he writes. 'Why can't noun and adjective be switched, to give "individualist institutionalism"' (Hodgson, 1986: 217.)

make the best of a world of limited resources. *Individuals wills are congealed into a form of collective volitiency or will-to-action*. Collective volitiency leads to collective action of many forms which are designed to control individuals at their work of disposing of scarce natural and human resources. (Gruchy, 1972: 41, emphasis added).

If Commons really does employ this notion of 'collective volitiency' in a serious way, he is in fact a holist in the strong sense. And in this 'congealing' of individual purpose into an indistinguishable (and epistemologically inefficient) mass, he would be guilty of the kind of methodological meltdown the individualist likes least.

Is Gruchy's interpretation of Commons the correct one? In part, I think, this picture of Commons as naive holist says more about Gruchy's views than about those of Commons. Rutherford (1983: 732) argues, by contrast, that Commons was a methodological individualist (in Agassi's sense). Much of the problem of interpretation arises because Commons himself was never very explicit about his method in this regard. What we *can* say is that Commons was never willing to make a distinction among types of institutions. Whereas Menger had distinguished between 'organic' and 'pragmatic' institutions, Commons preferred to blur the distinction, defining all institutions as 'Collective Action in Control of Individual Action' (Commons, 1934: 69). Thus he lumped together everything from common law to legislative commissions, from the family to the state itself. In one sense, then, Commons's research programme is complementary to that of the NIE. Viktor Vanberg (1989), for example, argues that Menger's programme is appropriate to those institutions that are 'organic' in nature and that Commons's focus is more appropriate to those institutions that are 'pragmatic'. This may be so. But the weakness of Commons's approach is arguably that he tended to see most – if not all – institutions as pragmatic rather than organic. The real debate is about the proper domain of 'pragmatic' explanations. And to misread a complex organic institution as pragmatic is effectively to engage in an undesirable sort of holism.

In a sense, we may say that Commons saw the same dilemma as Veblen, the same choice between sufficient reason and efficient cause. Since he saw no third way, he chose the Scylla of sufficient reason instead of the Charybdis of efficient cause that Veblen (or Ayres at any rate) had picked. And he ended up tempting – and perhaps succumbing to – the teleological fallacy against which Veblen had railed.

What about Veblen's objection? Are not many institutions in fact pragmatic in nature? Clearly Menger thought pragmatic institutions an important class of phenomena. Should not many institutions be explained as the result of the conscious design of individuals? My own view is that this objection is misdirected. Surely there are pragmatic institutions. We can explain the existence of, say, a small software firm by the intentions of its principals to form precisely such a firm. But even here, the firm

incorporates many other social institutions that are organic (like the price system in which it operates); more importantly, the firm may well work out in a manner quite different from what the founders had intended. Indeed, it has been the trend in modern scholarship to open up the 'black box' of such seemingly pragmatic institutions as firms, legislatures, or federal agencies and to see inside a pattern of individual motivation and partial knowledge implying surprising outcomes. The pragmatic model of institutions is the more narrow and primitive one – the one toward which we should be more suspicious.²⁶

4 Group 2: b) Instrumental valuing

If holism in Commons is what comes of being gobbled up by sufficient reason, then the 'instrumental' or 'technological' theory of value in Veblen and Ayres is what comes of being sucked down by efficient cause. This OIE value theory – ardently embraced by present-day proponents (Gruchy, 1987: Chapter 4) – is perhaps the single most scientific and anti-interpretive element in the institutionalist programme.

Veblen's Manichaeistic attitude toward sufficient reason and efficient cause had its operational counterpart in his famous distinction between 'industrial' and 'pecuniary' activities. This is what C. Wright Mills (1953: 3) described as Veblen's attitude of 'crackpot realism': he saw beneath the epiphenomena of prices and exchange a 'real' economic system tied to what is technological and industrial. The artificial pecuniary realm has a fundamentally negative effect on the real realm, manifesting itself through the pecuniary emulation of consumers and the industrial sabotage of financiers. It is to the industrial stratum, then, that Veblen looked for a 'scientific criterion of use value'.

According to this criterion the essence of a real use value is objectively determined by inquiring into the scientific basis of this value. For Veblen, value-in-use or real value rests on 'material circumstances reducible to objective terms of mechanical, chemical, and physiological effect'.²⁷ Value-in-use, he said, is objective in the sense that the use value of an object can be demonstrated by following the procedures of such laboratory sciences as physics, chemistry, and the other natural sciences. . . . By contrast, exchange or market values are described by Veblen as 'psychological' rather than objective. They are the source of pecuniary values that are based on 'caprice, good will, fashions, customs, prestige, effrontery, personal credit',²⁸ and primary concern for pecuniary gain at the expense of individual and community well-being (Gruchy, 1987: 68).

²⁶ To put it another way, the organic model is the more general. It already incorporates pragmatic elements – the intentions of the individual actors. It is straightforward to generalize this to cases in which actors working together in some common interest become some part of the overall explanation.

²⁷ Veblen (1919: 311).

²⁸ Veblen (1919: 307).

In Veblen's pessimistic scheme, the pursuit of pecuniary value would cause a progressive separation of the pecuniary realm from the real realm, leading to a crisis that could be resolved only with the advent of socialism, in which the two realms would be reunited.

Veblen's theory of value was the starting point for Clarence Ayres. Like Veblen, he saw a materialist technological realm of 'real' value underlying an epiphenomenal 'institutional' realm of 'ceremonial' value. Far less circumspect than Veblen, Ayres pushed the behaviourist implications of this view without embarrassment. Value, he admitted, must always have to do with means and ends. But he did not have in mind the full range of means and ends envisaged by the agents themselves; rather, he cast means and ends in terms of a continuum of 'operationally conditioned' acts. 'Whatever must be done before something else is operationally possible is identified as the "means" to doing that something else. . . . Every act operationally conditions every subsequent act. Every operation is the end of some earlier means, and the means to some later end.' (Ayres, 1952: 307). For Ayres as for Veblen, the 'technological' system of values is reduced and limited to the objective, 'warrantable' knowledge (Dewey's phrase) gained from experiment.

Unlike the pessimist Veblen (but like most other old institutionalists, including Commons), Ayres was an interventionist meliorist. Thus he did not see the tension between industrial and pecuniary values (technological and institutional values, in his terminology) as leading to the necessary death of liberal capitalism. The US economy could be saved, he thought, by using technological values as a guide. This normally meant intervention to destroy the 'ceremonial' institutions standing in the way of the otherwise quasi-ineluctable meliorist advance of science and technology. 'Ayres', says Gruchy, 'looked forward to the time when production and consumption would be balanced, incomes would be less unequal, and market values would reflect real or genuine use values rather than false or pseudovalues' (Gruchy, 1987: 76).

In one sense, then, the institutionalism of Ayres is as opposite to that of Commons as one could imagine: whereas Commons saw institutions as the necessary conditions to social improvement, Ayres saw them as primarily impediments. In another sense, however, following Ayres puts us at a point quite close to Commons. For the Veblen-Ayres dualism of value leads in practice to precisely the kind of holism Gruchy saw in Commons – holism that leads its practitioners to appraise institutions and public policies in terms of 'social' values somehow known by the analyst but not directly composed of the values held by the individuals involved.²⁹ This is an interesting bit of irony. Extremes have a tendency to meet in methodology

²⁹ This seems particularly characteristic of some present-day adherents to the OIE. See Gruchy (1987: 78–85).

as elsewhere. And here the explicitly teleological Commons meets up with the explicitly behaviourist Ayres. The reason is quite straightforward: both methodological extremes – pure sufficient reason and pure efficient cause – are empty alternatives. This is why Veblen cleverly refused to commit himself completely to either one. As Veblen understood, squeezing individual human consciousness out of the system leaves one with an ‘opaque’ model of society incompatible with meliorism. Like many before them, Ayres and his followers resolved this dilemma by allowing purpose to creep back in – but at the level of social ‘wholes’.³⁰ Thus they ended up with what they most wanted to avoid: the teleological fallacy.

Note, once again, that the issues here are not at all the ones normally supposed to be important. For one thing, the disagreement between the benchmark programme and the Veblen-Ayres value theory is not a disagreement about the ‘givenness’ or immutability of value. The benchmark programme in principle – and the NIE in practice – are quite interested in the formation of values and their embodiment in institutions.³¹ The disagreement is over the issues of holism and behaviourism, positions inconsistent with – or at best irrelevant to – Agassi’s institutionalism.

One unresolved issue remains: the problem of ‘value freedom’ in social science. But here too the issues are usually miscast. OIE writers tend to attack not merely the sometimes-asserted possibility of value-free economics but also the venerable fact-value distinction on which it is based (e.g., Hickerson, 1987). It is impossible in practice – and perhaps in principle – to remove value judgements completely from a scientific theory. This is no doubt correct. But it does not follow from this that we shouldn’t *try* to separate out what is value from what is fact. And it certainly doesn’t follow that we can *reduce* values to facts. The Veblen-Ayres theory of instrumental valuing is precisely an attempt to effect just such a reduction, in this case a reduction to ‘warrantable’ knowledge obtainable from natural-science-like experiments. The blurriness of the is-ought split argues for neither the possibility nor the desirability of this reduction. Moreover, if, as I believe, the reduction of values to facts is impossible, then the supposedly ‘objective’ social values announced by various OIE writers are not actually matters of scientific fact but have ultimately been supplied by the analysts themselves.

³⁰ This is exactly the same process that Veblen recognized in Marx (Veblen, 1919: 416, 436), who had kicked Hegelian spiritualism out the front door only to let it sneak in the back door.

³¹ Let me be clear here. I am explicitly disagreeing with the common view that the NIE differs from the OIE in that the former refuses to take the tastes of the agent as *explananda* while the latter insists that tastes must be part of the matter to be explained. It is certainly true that much of the NIE *does* take tastes as given, and that all of the NIE is much more cautious about pronouncing on the effect of institutions on tastes and values. But that is not necessarily bad. Moreover, there is within the NIE definite scope for and interest in the changing and formation of tastes. To explore these issues would take us too far afield, but for a relevant discussion, see Vanberg (1988a).

V

So much for the old institutional economics. But what about the new?

The prior question, of course, is *what is* the NIE? Is there such a programme and, if so, what does it consist of? As I suggested at the outset, Coats and Mäki were skeptical that the authors and traditions I had assembled³² actually constituted any kind of unified school. Nevertheless, the term new institutional economics has gained some currency, and it identifies a fairly well-defined area of economic writing.³³ This is, however, a somewhat narrower group than I tried to bring together, which accounts for some of the programmatic disunity Coats and Mäki uncovered. The narrower group is concerned with the theoretical explanation of social institutions in the spheres of economic history, industrial organization, law, and even morality. All these analyses have in common the use of the maximization metaphor as an organizing principle at some level. Although fundamentally neoclassical in orientation, members of this group see themselves as going beyond and correcting deficiencies in the basic neoclassical story. My own tendency has been to stress the differences of the NIE from neoclassical economics, and to broaden the well-recognized core to include such dissident traditions as the radical subjectivists influenced by G.L.S. Shackle (Littlechild, 1986); the modern Austrian school influenced by Hayek (O'Driscoll and Rizzo, 1985); and the neo-Schumpeterian economics of Nelson and Winter (1982). This obviously makes it more difficult to tell a persuasive story about overall programmatic unity in a sociological sense; but it is useful as a way of both broadening and criticizing the neoclassically oriented core of the NIE. For what is 'wrong' with the NIE, in my view, is some bad habits borrowed from neoclassical economics.³⁴

To put it another way, the problem with the NIE – like the problem with the OIE – lies in its divergence from the benchmark programme I set out in section III. But the problem in this case is of a rather different order. Whereas the OIE was loaded down with a number of doctrines – holism, instrumental valuing, etc. – that are plainly inconsistent with the benchmark programme, the NIE carries with it little that is not *potentially* consistent with the benchmark. Indeed, the NIE carries little methodological baggage at all, and what it does tote around is basically neoclassical. And – perhaps surprisingly – neoclassicism has managed to keep burning a much brighter flame of interpretive method than the OIE. While the orthodox methodological rhetoric of neoclassicism may have been

³² In Langlois (1986a).

³³ See, for example, Basu, Jones and Schlicht (1987). Also, the *Journal of Institutional and Theoretical Economics* has published a number of symposia on the new institutional economics.

³⁴ In some instances, of course, 'bad habits' may be a bit of an understatement. But I come to damn the NIE with faint praise, not to bury it.

influenced by logical positivism, and while the techniques of neoclassical economics may have been borrowed from nineteenth-century physics, the underlying conception is still that of an agent trying to do as well as possible in a particular situation. This is what survives in neoclassical economics of the legacy of Weber and the Austrians. Indeed, if we concentrate on the informal or 'appreciative' stories economists tell in their undergraduate classes rather than the formal models they build, the method of neoclassical economics still looks very much like situational determinism (Langlois and Koppl, 1984). And it is this older, less formal picture of economics that NIE writers typically find appealing. Far more than the OIE, the NIE has interpretive roots to be rediscovered.

But the programme of the NIE - particularly that of the more neoclassical core is by no means identical with the benchmark for which I have argued. That benchmark, recall, had two aspects: 1) the programme of institutional (as distinguished from psychologistic) individualism; and 2) the Smith-Menger programme of 'organic' or invisible-hand explanation. We thus have two fronts of potential criticism: we can assert that the NIE core is too psychologistic or we can argue that it fails to apply invisible-hand compositional principles. The latter is, I think, the more important line of attack.

One important critic of the neoclassical side of the NIE has taken the first tack. Alexander Field (1979; 1981; 1984) has persistently argued that 'neoclassical' institutional economics³⁵ fails because it adheres to what I have called a psychologistic programme.³⁶ To Field, the NIE seeks to 'endogenize' institutions by reducing them to tastes, technologies, and endowments - the characteristic 'givens' of neoclassical theory - but not to other institutions like rules or laws. Such a reduction, Field argues, is both undesirable and ultimately impossible. I think this is basically correct; and it probably does characterize the programme of some writers like Becker, Posner, or (at times) North. But this kind of reductionism does not characterize all of the programme. Such otherwise neoclassical writers as Coase and Williamson have no interest in eliminating institutions from the explanation of institutions. And, if we broaden the field to include writers like Hayek, we would actually embrace strong critics of the psychologistic position.

Moreover, as Basu, Jones, and Schlicht (1987) have pointed out, rejecting psychologistic reduction as an ultimate goal of an NIE programme does not imply that we must reject all attempts within that programme to explain institutions on the basis of tastes, etc. For example, the game-theoretic

³⁵ He seems to mean by this the most neoclassically oriented elements of the NIE, notably Douglass North's analysis of economic history and Richard Posner's economic analysis of law.

³⁶ See also Mirowski (1986), who applies Field's line of criticism to the game-theoretic model of social rules.

explanation of rules we find in, say, Schotter (1981; 1986) starts from a highly abstract situation in which there are only tastes and states of the world. But there is no reason why this model cannot be fitted into a more textured – and institutional – theory when applied to particular concrete areas of inquiry.

The more important and interesting line of criticism, it seems to me, arrives from the other direction. The problem with the NIE – or the quasi-neoclassical parts of the NIE, at any rate – is that it often fails to be careful about its compositional principle and about the connection between that compositional principle and the assumption of maximization. I and others have developed this line of criticism in detail elsewhere (Langlois, 1984; 1986b; Dow, 1987; Basu, Jones and Schlicht, 1987), so all that is needed here is a brief run through.

It is typical of some authors to explain an institution – the last-clear-chance doctrine in tort law, for example, or the M-Form structure in business – as ‘efficient’, that is, as maximizing some objective relative to other available institutional alternatives. The institution maximizes wealth (Posner) or (what can amount to the same thing) minimizes the sum of production costs and transaction costs (Williamson). We could also imagine other ways of framing the maximization. Now, this clearly has some heuristic appeal, since it ties the explanation of the institution to well-known principles of economic behaviour. But there is also some difficulty with this formulation. We should immediately want to ask a number of questions. In what sense does efficiency *explain* the institution? Is its efficiency the *cause* of the institution? And who or what is doing the maximizing here?

The typical response to these questions would be to invoke a compositional principle or, more specifically, a selection argument. Inefficient institutions tend to lose out in competition with efficient institutions; thus the efficient institutions should be the ones we observe; and the analysis from efficiency becomes an acceptable shorthand for the more complex selection process that would actually explain the existence of the institution. In short, this is a kind of functionalist explanation that couches the institution’s function in terms of its solution to a maximization problem. There are a number of difficulties with functionalist explanation in general (Ullmann-Margalit, 1978; Elster, 1983). This particular form of the explanation skirts some problems but presents others (Langlois, 1986b).

How does this kind of explanation answer the questions posed above? The explanation is an attempt to finesse the ‘who is maximizing?’ question by invoking the system constraint in a big way: it is an attempt at an argument from efficient cause. It does not matter (the argument would go) whether the institution was consciously or accidentally invented; all that matters is that the selection mechanism operate effectively to filter out institutions that do not maximize in the appropriate way. There are a

number of problems with this approach. But notice, first of all, that this is not an explanation of the origin of an institution. It is at best an explanation of the persistence of the institution. And it is not even a good explanation of persistence unless it identifies – as most invocations of this approach do not – a specific feedback mechanism that sustains the institution (Ullmann-Margalit, 1978; Elster, 1983).

But what is ultimately most troubling about this mode of explanation is that it is obscurantist. It is an attempt to use the idea of a selection mechanism not as an explanatory device but as a justification for not paying attention to the processes involved. The maximization metaphor is an extremely appealing and powerful ‘positive heuristic’ for a theoretical structure. It is easy to use, and it provides an explanation in terms of a widely applicable set of fundamental ideas. But only in a very restricted set of situations is it in fact a substitute for looking at the actual process by which institutions come into use and are maintained over time. We have good reason to think that many processes leading to institutions do not select for efficiency (that is, they maximize something other than wealth or the negative of the sum of production and transaction costs). Moreover, even if a process *does* select for efficient institutions,³⁷ the maximization formulation can run into logical problems unless the selection mechanism operates extremely swiftly and effectively.³⁸ In view of this, it seems much more reasonable – and much more in keeping with the spirit of the benchmark programme – to look beyond the maximization metaphor to a consideration of the actual process involved. That an institution economizes on transaction costs is an important part of the story; but it is not the whole story.

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³⁷ As, broadly speaking, business competition probably selects for efficient business practices.

³⁸ Specifically, weak selection pressure or a more or less prolonged weeding-out process can lead to problems of disequilibrium and path dependency (Langlois, 1984; 1986b; 1988).

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