

# THORSTEIN VEBLÉN AND HIS INSTITUTIONAL ECONOMICS

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Contrary to the hedonistic conception of the Austrian and Losanna Schools appeared the Institutional School, led by Thorstein Veblen<sup>1</sup> and his followers, John Rogers Commons, W.C. Mitchell, G.C. Means, N.W. Stewart, S.H. Slichter, W.F. Ogburn, A.B. Wolfe, W.E. Atkins, J. Dorfman, W.H. Hamilton, C. Tugwel.

The Institutional School<sup>2</sup> through the institutional economics formulated by it revised the economic tradition in America, which was an extension of the European Schools, and attempted to combine theoretical concepts with reality. New techniques, and organizational spirit created this purely American School.

1. W. Jaffé: *Les théories économiques et sociales de Th. Veblen*, Paris, 1924. J. Dorfman: *Thorstein Veblen and his America*, New York, 1939. W. C. Mitchell : *What Veblen Thought*, New York, 1956. J. Hobson : *Thorstein Veblen*, 1937-L.E. Hill : *An analysis of the History and Methodology of Institutional Economics* in «International Congress of Economic History and History of Economic Theories» in Piraeus, 1975.
2. W.H. Hamilton : *The institutional approach to economic history*, in «The American Economic Review», March, 1919, Vol. IX. Jenny Grizioiti- Kretschmann : *La Teoria Générale de Valore nell' Economica*, in «Giornale degli Economisti!», Vol. XVI, 1938. A. Gruchy : *Modern Economic Thought*, New York, 1947. G. Pirou : *Les Nouveaus Courants de la Théorie Économique aux Etats Units*, Vol. I-II, Paris, 1947. A. Fanfani : *Il Neovolontarismo Statunitense*, Milano, 1946. J. Dorfman : *The Economie Mind in American Civilization*, Vol. III Chap VIII (1949) and Vol. 4, Chap XHI (1959). *The Institutional School in «Encyclopedia of Social Sciences»*, Vol. V. M. Burns : *Institutional ism and Orthodox Economics* in «The American Economic Review», XXI p. 80 ff. L. Th. Houmanidis : *John Rogers Commons e zoe kai to ergo tou*, in "Archeion Ekonomikon kai Koinonikon Epistimon», Vol. IV. Athens, 1963.

The institutionalists use mainly the sociological and statistical method, to opposition to the preceding individualistic Schools, which adopted the abstract method supplanting the facts and turned their endeavors toward the conceptual and a priori construction of an ideal and perfect world instead of the real and imperfect one. The institutionalists accepted induction and through statistics examined quantitative changes of economic phenomena in place and time, but they avoided the simple recording of those to follow their chronological and economical structure as the historiographic working groups of the Historical School had done. The institutionalists based themselves on human psychology, which changes according to the era and the various countries. Thus these writers overthrew the universal laws of the classicists, since, according to them, the economic phenomena are included within the social and legal institutions, which are always changing and which always reflect the time and the place within which they are formed.<sup>3</sup> Thus ownership and competition are examined as various types of ownership and various types of competition.

According to these economists the economy is not governed by eternal and unchangeable laws, as the classicists and generally the adherents of liberalism proclaimed. There are no laws which obligatorily guide the society to peace, order and social justice. The institutionalists placed themselves opposite the naturalists and while via the social factor and the social values they accepted the supra-individual influence on economic function, at the same time they believed that this was created not by laws of natural order but by those people through the institutions shaped by them, which in their evolution propel the society and the economy toward progress and indeed through the intervention of the state toward the avoidance of bad and non-adaptive institutions and social progress.<sup>4</sup>

The institutionalists also examined the lack of economic equilibrium since reality cannot be reconciled with the existence of economic equilibrium, and distinguished, as for example, the Frenchman Francois Simiand, fluctuations of long, middle or short cyclical duration. In general if the classicists and the following individualistic schools (Austrian School, Mathematical School, Neo-classical School) were based on rational and individualistic factors, the institutionalists examined economic phenomena from the viewpoint of group and non-rational factors. Thus,

3. G. Pirou : *Les Nouveaux Courants* .Vol. I. p. 13, Thus they called it the Neo-Historical School. E. James maintains that the School was more occupied with statistics than with history (E. James: *Histoire de la Pensée Économique au xxe siècle*, Paris 1955, Vol II. p 112-113).

4. Concerning the Voluntarism of the Institutionalists see K. Polanyi : *The Great Transformation*, 1944.

for Homo Oeconomicus the institutionalists substituted Homo Organizer<sup>5</sup> who moved not within an imaginary world but with a real world, in which is taken into account the importance of fashion, propaganda, tradition and habits.<sup>6</sup>

In brief, the basic conceptions of the Institutional School are as follows : a) all economic research must be based on the behavior of the groups and not the price mechanism, and human behavior is continually changing, b) economic generalizations are relative to place and time, while the morals, customs and laws are ways of organization of economic life, c) motives of great importance which influence man cannot be measured and d) the adaptations in economic life must not be examined as setting off from a static equilibrium ; these are only stable under existing institutions.<sup>7</sup>

Thus the law of supply and demand on the basis of the individualistic and abstract view of full competition is set aside so that a new institutional and real economic morphology will arise.

The group of sociologists which made up the Institutional School, based, as we saw, the dynamic of their economic psychology on the supra-individual factor, the institutions<sup>8</sup> which influence the economic behavior of individuals. The influence of the philosophers William James<sup>9</sup> and John Dewey<sup>10</sup> contributed to this.

The supporters of the old subjective psychology John Locke<sup>11</sup> and George Berkeley<sup>12</sup> viewed the mind as the passive producer of ideas, which make up the world of reality and which reflect on it and which is a simple mechanism for their depiction.

5 A. Fanfani : II Neovolontatismo statunitense, p. 2

6 G. Pirou : op cit, p. 17.

7 L. Haney : History of Economic Thought, New York 1951 p. 719 - 720.

8 Gruchy following A.B. Wolfe maintains that the first one to use the term «institutional» was Max. S. Hardman (A Gruchy : op. cit. p. 2). However, J. Dorfman believes (op cit. Vol IV, p. 353) that it was W. Hamilton (1916). L. Harter maintains that the term «institutional», was first introduced by W. Hamilton at the Conference of the «American Economic Association», in 1918, (L. Harter : John Rogers Commons, His Assault on Laissez Faire, Oregon, 1962, p. 243).

9 W. James : Pragmatism, 1907, Greek trans, by K. Papalexandrou : «O Pragmatismos», Athens 1925.

10 J. Dewey : Reconstruction of Philosophy, 1920, and Experience and Nature 1927.

11 J. Locke : Essay Concerning Human Understanding, 1660.

12 G. Berkeley : Principles of Human Knowledge, 1710.

Philosophical pragmatism<sup>13</sup> came into conflict with this static and mechanical view of psychic life and confronted it with the dynamic one under a continual current of impressions and ideas, shaped by the mind. Our concepts and knowledge, according to philosophical pragmatism, lead us to empirical life through our intellect, based on experience, for the correct judgment of the usefulness of things for life (James). Intellect and concepts are the instruments for the mastery of reality from the spiritual and practical side (Dewey). Thus the mind, for the now social psychology, constitutes the active factor of the activity of man and indeed of his social action.<sup>14</sup> In this sociological psychology the behavior of man is included.

The institutionalists, continually under the influence of philosophical pragmatism, accepted the mind as an active factor, maintaining a creative relationship between the mind and the exterior world.<sup>15</sup> Based on group behavior, they examined economic behavior believing this to be moved by the instincts, which were shaped by conditions brought into being by the influence of the social environment.

The leader of the School, Thorstein Veblen, son of a Norwegian immigrant, was born in 1857 in Wisconsin and grew up in Minnesota. At Carleton College (1880), where he studied, he had John Bates Clark as instructor. Veblen wrote his basic work at Johns Hopkins University and Yale where he received his doctorate (1884). He also worked at the Universities of Cornell and Chicago. At the age of 39-43 he was an assistant while his former classmates had already become full professors, heads of departments and Presidents of Universities. This delay in his academic career was contributed to by the character of Veblen and the manner in which he confronted his instructing role and his position as a professor. Despite the fact that he published eleven books, he never became a full professor and many of these books were published at his own expense. Besides Chicago, Veblen also taught at Stanford, Missouri and the New School for Social Research moving from university to university because of his poor instruction and his indifference to his students.

In 1911 he worked for a while for the Food and Drug Administration in Washington D.C. publishing, «The Dial.» Fortunately for Veblen, a former student helped

13 The American Philosopher Charles S. Peirce first used the term, «pragmatism».

14. R. Faris : American Sociology in «Twentieth Century Sociology», New York, p. 538ff. B. Watson : Behaviorism, 1924.

15. J.R. Commons : Institutional Economics, The University of Wisconsin Press, Madison 1959 Vol. I p. 150-152, Vol II pp. 646-647, 654-655.

him monetarily in the last years of his life when he foresaw the great world-wide crisis. He died in 1929.

Veblen, influenced by the new wind that blew in America during the last quarter of the 19th century, in philosophy as well as in science, turned from the static and the mechanical view of economy to the dynamic and social view of it. Thus the neo-classical thought in America (John Bates Clark, T.N. Carver, H. J. Davenport, F.W. Taussig) exercised a harsh criticism of the institutional concepts of Veblen, whose work was influenced by Charles Pierce, W. James, J. Dewey, P. Ely, S.N. Patten Baldwin, G. Stanley Hall and Charles H. Cooley.

Veblen published the following main works : The Theory of the Leisure Class (1899), The Instinct of Workmanship and the State of the Industrial Arts (1914), The Vested Interest and the State of the Industrial Arts (1919). The Engineers and Price System (1921), Absentee Ownership and Business Enterprise in Recent Times (1923).

Veblen argued that : «The life of man in society, just like the life of other species, is to struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions. The progress which has been and is being made in human institutions and in human character may be set down, broadly, to a natural selection of the fittest habits of thought and to a process of forced adaptation of individuals to an environment which has progressively changed with the growth of the community and with the changing conditions under which men have lived.»<sup>16</sup> Institutions, according to him, are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes ; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection. The development of these institutions is the development of society.<sup>17</sup>

The institutions are essentially the prevailing morals and habits plus respect contradistinction to the special relationships and functions of the individual as well as of the society. However, these institutions, though in force today, may not correspond to the situation existing today. Thus the duel between conservatism and progress is called forth, which is due to the conflict between the institutions in force and the needs for new ones corresponding to the existing conditions of spiritual and material life. The society, however, is finally changed, developed and adapted ac-

16. T.Veblen : Theory of Leisure Class, *éd.* London, 1957, p. J 88ff.

17. T. Veblen : *Ibid.*

according to the changes in the habits, the morals and the expectations of the various classes of society.<sup>18</sup> And social evolution is precisely this spiritual adaptation of individuals to the conditions of today which are a product of yesterday. Thus the economic doctrine must harmonize the internal relations with the external ones, that is, with the total environment within which these relationships are formed.

Thus arises the significance of economic institutions, which unite the procedure of the life of the community with the material environment within which this is developed. The methods, however, which these institutions produce in the community toward its evolution, are not independent of those of the past, because the older institutions survive in the newer ones. But as the population increases and the new needs appear and human knowledge and ability broadens these methods cannot correspond to the created conditions. So the need arises for a change in the existing institutions and the creation of new ones, adapted to the new reality. And since these institutions relate to the environment, within which the individual and in general, the society develops, first of all we must take the economic institutions into account. These govern the modern industrial society and we must give the greatest importance to them<sup>19</sup>.

Thus the Institutional ideas of Veblen came face to face with the Marxist materialistic conception of social evolution<sup>20</sup>.

Thorstein Veblen, follows John Dewey, according to whom the struggle in society is endless; he maintained that we have in society continual competition and conflict of interests, which, however, do not refer to a class struggle but to various social levels, i.e., workers and employers, producers and consumers, lenders and borrowers, small merchants and large ones etc. This conflict of interests between the various social levels can become intensified to an excessive degree, but they never reach the stage of overthrowing the social equilibrium. Because, despite the

18. T. Veblen : p. 191.

19. T. Veblen : p. 195.

20. Veblen base his ideas on a fundamental principle : dichotomy, as Professor Hill maintains. Veblen used this dichotomy to distinguish between good and bad or between creation, construction, productive propensities (instincts) and destructive exploitation, wasteful propensities (instincts). «The Veblenian dichotomy - Hill says - was probably a synthesis of Sigmund Freud's concepts of the life and death instincts with the dialectical method that had been developed by Hegel and Marx. On the foundation of this dichotomy Veblen built his theory of human behavior which was both pragmatic and evolutionary (L. E. Hill : op. cit. p. 155).

opposition of interests, there is a mutually dependent relationship between the various social levels on behalf of the general interest of the preservation of the social equilibrium for the benefit of all<sup>21</sup> Thus the various social levels avoid destroying each other, afraid of producing a crack in the social structure, which if it collapses will bring about the destruction and the decline of the whole. Also, while Marx dialectically reached what was for him the highest degree of social organization, communism, Thorstein Veblen believed that the competition waged between the various social levels led to various beneficial reforms, each of which are expressed through the institutions in force toward the benefit of the social whole.

The institutionalists, supporting the principle of social control, stood face to face with the individualistic school of economy, whose main point of interest was the behavior of «homo oeconomicus -economic man», who is their ideal type, moved on the basis of egotistical motives between pleasure and pain, within a perfect competition, for the achievement of his greatest interest. Such a utilitarian philosophy and such an abstract conception of an individual who acts within hypothetical perfect competition, without any obligation, without any influence of supra-individual factors, constituted for these sociologists a groundless, and in addition, anti - social view.

The institutional voluntarism, however, not only rejected every shade of naturalism, but also would have nothing to do with the old voluntarism, celebrating instead the human personality, on behalf of which it wanted to construct its society.

According to Veblen, the needs of man are best satisfied when technique and science, wearing down the resistance of nature, are drawn into his service. This however, is one picture of man ; the second is when we take him as a historical product and therefore as a social being and we examine what influence the institutions have on him and the behavior of ones like him. Thinking like this, the institutionalists maintained that there was a necessity for control so that society could be protected from the domination of the weak by the strong. They accepted that this control did not refer only to the activity of the State but also to the influence on the behavior of people exercised by religion, traditions, the associations of production, consumption, etc.

For Veblen, until this period, economists worked based on a hedonistic psycho-

21. The Institutionalists and especially Commons, in their solidarity perception were influenced by the solidaritism of Léon Bourgeois (See International Organization of Social Polcies in «The American Labor Legislation Review», 1914, Vol IV, pp. 186-202).

logy and a static perception concerning the internal and immutable laws of the economy and social life in general. The ideal type, «economic man», reckoning pleasure and pain, who had no past or future, but was turning about one and only one hub, obeying his egotistical instincts like a puppet was, according to them, an un-supportable abstract hypothesis, because it results in a metaphysical and ideal conception, which removes us from the world of reality. Because individual behavior does not have any meaning, belonging as it does to the microcosm and only in the society with its valid institutions which springs from reason and are expressed through the instincts can meaning be found. Social life, through its variety and biological and social relations, is reality; it is the cause for the change in institutions which in their turn change each instinct of man and determine his way of life and development.

Thus, in their economic behavior, men are influenced by supra-individual factors, which evolve in the historical course and change from one historical stage to the next. These stages according to Veblen, are: primitiveness, wars, professional labor and machinism. This last stage is divided into two: the industrial and the financial-monopolistic. During the industrial stage free competition hatches the disadvantages, which appear during the stage of financial monopolistic economy.

For Veblen the world of reality, as this is shaped through the continually evolving institutions, is semi-monopolistic or monopolistic in character and which is this economic life and not the partial phenomena of it. Profits owe their realization to this semi-monopolistic or monopolistic situation of the market by means of a series of sales and purchases, not prices realized by perfect competition.

In addition, Veblen, believes that goodwill is the greatest individual differential advantage, in relation to the firm, the confidence of exchanges, the enjoyment of special privileges, etc. This advantage is a surplus income of these individuals over others, who accept this because it is institutionally acceptable; here arises the harmonization of the interests of individuals, either as willing buyers or as willing sellers.

Because of the strength of monopolistic and financial capital, Veblen objected to the monopolies, as well as uncontrolled competition, which fatally led to the monopoly of the market, with its catastrophic results. He observed that the entrepreneur did not move in harmony with the interests of society, because his aim was to become rich and to monopolize the market for his own benefit, since his profit would be larger, as the more he dominated the market, that much more favorable would be the pre-conditions of the exploitation of consumption appear to him and that much more favorable would the conditions of the exploi-



tation of labor appear to him, so that with the expansion of finance capital he would distinguish in the development a continually developing economic instability.<sup>22</sup>

In this stage of social development, the economy takes the form of the monopoly and its domination in the market, breeding egotism, greed for profit and social differentiation. The only way to turn people away from this road is with the reform of the system, through the application of social control and the regulation of the boundaries of business enterprise.

Because, according to Veblen, the entrepreneur avoids the largest production, afraid that this may exceed the limits of the largest profit ; it is in his interest to lower the working wage even if by the least amount, so that his total percentage of profit will be larger, without this becoming immediately perceptible, since the lowering of the worker's wage is done per capita. But when the wages rise, the worker again finds himself in his former position, because as the entrepreneur raises the wages, he puts a burden on consumption to which the worker is joined. The exploitation by the entrepreneur especially stands out when we examine the economic cycle, where we see that during the rising of the cycle the businessman speculates at the expense of the worker, whose wages do not follow the rise in prices, while during the fall in prices the exploitation continues, with the discharge of workers, lock out, the lowering of wages and the like.<sup>23</sup>

For the worker there is another opposite mentality, «...because the standard of living of any class, so far as concerns the element of conspicuous waste, is commonly as high as the earning capacity of the class will permit - with a constant tendency to go higher. The effect upon the serious activities of men is therefore to direct them with great singleness of purpose to the largest possible acquisition of wealth and to discountenance work that brings no pecuniary gain»<sup>24</sup>.

Veblen, as most institutional economists, tried to solve practical problems. His methodology was inductive not deductive. On the other hand we must not forget that «institutionalism was born in the chaos of the transition from a rural cooperative agrarianism to an urban monopolistic industrialism»<sup>25</sup>. Veblen's method involved «the application of inductive logic to empirical observations that were drawn from History»<sup>26</sup>, while «his criticism was brilliant and incisive»<sup>27</sup> and this criticism was exercised against monopolistic industrialism.

According to the above ideas, expressed by Veblen and his school, a system was

22, 23 T. Veblen : The Theory of Business Enterprise, 1984 p. 16ff.

24. T. Veblen : p. 112.

25. L.E.Hill : op. cit. p. 155.

26. 27. L. E. Hill : p. 156.

of reforms was proposed based upon a social control in order to be limited the individualism which cause the social conflicts and social differentiation. For this reason Veblen was accused by marxists as fascist and by conservatives as very radical but Veblen, as Sismondi, is Veblen. He opened a new road, his own road, which impacted also the economic policy of the USA and especially the New Deal (1933 - 1935) of Franklin Roosevelt.<sup>28</sup>

28. Some adherents of the school have not agreed with the New Deal policy as H. G. Moulton and his collaborators of Brooking Institutions (G. Pirou : Les Nouveaux Courants de la Théorie Economique aux Etats - Unis, Paris 1947, Vol. II, p. 150 - . L. Frank : L'Expérience Roosevelt et le milieu social Américain, Paris 1937).