ARTICLE

The Nature of Institutional Economics

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Abstract

My purpose here is to question the nature of the economics project of old institutionalism. I first critically examine a conception of it that is currently prominent in the literature before advancing and defending an alternative.

Keywords: institutionalism, institution, heterodox, mainstream, ontology, process, stability.

My topic is the nature of the project of (old) institutional economics. The project has a significant presence in North America, Europe and, increasingly it seems, in Japan. And recently there seems to be some emerging widely spread consensus as to its nature, at least amongst some leading North American and European contributors. I am thinking, in particular, of the prominent assessments of Geoff Hodgson (2000) and Anne Mayhew (2000). In truth I find myself convinced by very many of the assessments of these two authors on related matters, though not quite on their view of the nature of the old institutionalist project. I thus thought I might take the opportunity provided by the invite to contribute to this new Japanese institutionalist journal, to explore this topic of apparent disagreement.

A Current Interpretation of Old Institutionalism

So what, first of all, is current thinking on the nature of the project of old institutionalism that I associate with Geoff Hodgson and Anne Mayhew amongst others? The conception I have in mind is one that has been explicitly formulated by Hodgson and actively responded to by Mayhew. Let me, then, start with the former.

In a paper titled “What is the Essence of Institutional Economics?” Hodgson sets out a “rephrased and expanded” version of his interpretation of the description of

JEL: B25, B52.
institutionalism first advanced by Walton Hamilton (1919)\textsuperscript{1}. This takes the form of five sets of propositions, which can be summarised as follows:

**Institutionalism**

1) though of practical relevance, is not defined in terms of policy proposals;
2) is highly interdisciplinary;
3) regards institutions as "the key elements of any economy", and so their study "is a major task for economists" (2000, p. 318);
4) treats the economy as an open and evolving system, situated in nature, affected by technological change, and "embedded in a broader set of social, cultural, political and power relationships" (p. 318); and
5) treats individuals not as fixed (utility maximisers) but shaped by their institutional and cultural situations.

Hodgson suggests that these propositions contain the hard core of the institutionalist tradition. However, he emphasises 5) as the more important, so let me give his formulation of the latter in full:

\textbf{5*)} "The notion of individual agents as utility-maximising is regarded as inadequate or erroneous. Institutionalism does not take the individual as given. Individuals are affected by their institutional and cultural situations. Hence individuals do not simply (intentionally or unintentionally) create institutions. Through 'reconstitutive downward causation' institutions affect individuals in fundamental ways" (Hodgson, 2000, p. 38)

As I say Hodgson sees the latter proposition as by far the more important feature of institutionalism. Indeed he writes:

"The contention here is that [these five propositions] contain the "hard core" of the institutionalist tradition.

I further assert that the single most important defining characteristic of the old institutionalism is proposition (5) [5*above-\textsuperscript{T}L]. Among other schools, the new is distinguished from the old institutionalism in precisely these terms. Other criteria do not demarcate the old institutionalism so readily. Other schools of economic thought also express some concordance with propositions (1) to (4). In contrast, proposition (5) [5*above] is a guiding thread through which the whole institutionalist tradition,

\textsuperscript{1}It was Walton Hamilton who apparently first coined the term "institutional economics" in presenting the referenced paper at the Meetings of the American Economics Association in 1919.
from Veblen to Galbraith, and it is rarely acknowledge or developed elsewhere” (Hodgson, 2000, p. 319).

In commenting on Hodgson’s paper Ann Mayhew makes it clear that it is indeed the forgoing conception of institutionalism that she has long endorsed:

“Let me begin with Geoff Hodgson’s paper, for it is an easy task for me to say that I agree with Geoff that his item (5) is the crucial and defining characteristic of institutional economics. As I have said this in print on a number of occasions over the past 10 years or so, I have no trouble in saying ‘amen’” (Mayhew, 2000, p. 331)

Of course, Mayhew recognises that the direction of causation from agency to structure, including institutions, or, in her emphasis, culture, is both ways (even if her use of the term “creation” must be interpreted with caution):

“It is obvious that culture is necessarily a creation of people and that this is so even if we also accept that people are creations of their culture” (Mayhew, 1987, p. 590).

Reiterating the thrust of this earlier work Mayhew refers to Hodgson once more:

“As I understand [Hodgson], he is saying that what is distinctive and attractive about institutional economics is the emphasis on seeing people as cultural animals, or, in his words, as ‘institutionalised individuals’. Absolutely” (Mayhew, 2000, p. 331)

And Mayhew sounds the optimistic note that because other social scientists, especially anthropologists, have long adopted this emphasis, institutionalists can learn from the relevant literature:

“As institutionalists struggle with how to handle the “reconstitutive downward causation” that learning is, they can take heart and learn from the other social scientists who have, for more than 20 years, been developing ways of treating encultured humans as creative, learning, and conniving creatures as well. In anthropology, for example, the concept of culture has been redefined over the last several decades to incorporate the notion that shared symbols and meanings are used in many ways by active individuals” (Mayhew, 2000, p. 331)

**An Implied View of the Institution**

Now I do not deny that institutionalists have long been interested in the social or cultural nature of human individuals. However the notion of downward reconstitutive causation seems to presuppose the realist notion of emergent social phenomena, including social structures, that is of phenomena emergent from human interactions, but possessing powers of their own capable of acting back on individuals in both conditioning or moulding their dispositions as well as structuring courses of actions available (see e.g.,
Lawson, 1997, 2003a, 2003b). Elsewhere, however, I have indicated that prior to recent developments in realist social theorising the institutionalist tradition did not really possess these ontological resources relating to emergence, and so were unable consistently to capture the idea of downward reconstitutive causation (see especially Lawson, 2003b). As such this interpretation of Hodgson’s and Mayhew (as opposed to the less specific claim that individuals are social or cultural in nature) cannot easily be said to be rooted in the history of the tradition.

Now it seems to me desirable to attempt to characterise a venerable project like old institutionalism in terms of its traditional concerns. But whilst Hodgson and Mayhew likely agree with this others may not. Some may conceivably hold that, whatever the historical record, reference to a concern with downward reconstitutive causation is a reasonable way to distinguish the modern project of old institutionalism. However, if it is, then we might reasonably expect to find the institution being distinguished as the aspect of the social world with the property of being ‘reconstitutive’ of human individuals or agency. Similarly we might expect to find that competing heterodox projects do not themselves emphasise “downward reconstitutive causation”. We can quickly see, though, that neither of the latter two conditions hold.

It is true that Hodgson recently writes:

“Institutions are social structures with the capacity for reconstitutive downward causation, acting upon ingrained habits of thought and action. The downward causation of institutional structure upon agents results in a reconstitution of purposes and preferences. Causal powers and constraints associated with institutional structures can encourage changes in thought and behaviour” (Hodgson, 2002, p. 172)

However, Hodgson is not here defining an institution, just observing that institutions have this property, and I can find no institutionalist who does define institutions as the sole source of this “downward reconstitutive causation”. Nor should they be so defined. For in truth all social structure appears to possess the capacity in question; in particular all social structure can act upon “ingrained habits of thought and action”. Causal powers and constraints associated with all social structures “can encourage changes in thought and behaviour.”

Of course, to the extent institutions are relatively enduring—and I believe that endurability is their distinguishing feature (see below)—there is more chance they will serve in the moulding overtime of the habits of those who come under their influence. But this is quite different to supposing that their ability to downwardly reconstitute is a distinguishing feature of them.
How about the idea that old institutionalism can be distinguished through its emphasis on 'downward reconstitutive causation'? Now whether or not all institutionalists accept Hodgson's proposition 5), I believe that it is also accepted in the other heterodox traditions. Even Austrian (self-proclaimed) individualists such as Hayek accept the insight behind 5). Thus, for example, Hayek writes:

"It is less accurate to suppose that that thinking man creates and controls his cultural evolution than it is to say that culture, and evolution, created his reason. ... What we call mind is not something the individual is born with, as he is born with his brain, or something that the brain produces, but something that his genetic equipment (e.g., a brain of a certain size and structure) helps him to acquire, as he grows up, from his family and adult fellows by absorbing the results of a tradition that is not genetically transmitted. ... Shaped by the environment in which individuals grow up, mind in turn conditions the preservation, development, richness and variety of traditions on which individuals draw. ... It may well be asked whether an individual who did not have the opportunity to tap such a cultural tradition could be said even to have a mind." (Hayek, 1988, pp. 22–23).

Whether or not we agree wholly with Hayek, it has to be admitted that Hayek's view here hardly conflicts with Hodgson's proposition (5) [proposition 5*above]. And moving to the modern day, of course, modern Austrians, as well as post Keynesians, Feminist, Marxian and social economists and others would find each of Hodgson's Hamiltonian propositions easily acceptable, and indeed accepted.

An Alternative Conception of the Nature of Institutionalism

So how am I suggesting we should distinguish the project of old institutionalism? I reiterate that my goal is a conception that preserves the historical orientation of that project. Now because there is often thought to be a good deal of overlap between the various heterodox traditions, I need to distinguish institutionalism both from other heterodox traditions as well as from the dominant modern mainstream project. So let me first indicate how I think all the heterodox traditions part company with the mainstream, and then indicate the manner in which I believe the various heterodox groupings are to be differentiated from each other. These are matters I have sought to address elsewhere (Lawson, 2003a). My assessment, in brief, is that:

1) A distinction between the modern heterodox traditions in economics and the mainstream approach can be coherently sustained only on ontological, rather than substantive or policy, grounds.
2) The different heterodox traditions can be coherently distinguished from each other not on ontological, substantive or policy grounds, but according to their individual concerns or questions of interest.

Let me briefly elaborate.

The modern mainstream tradition, as I have elsewhere demonstrated (Lawson, 1997, 2003a, 2005), must be characterised itself not in terms of substantive theories or policy stances but in terms of its method: the one enduring and distinguishing feature of the project is its insistence that all economic explanation be couched in terms of mathematical-deductivist methods.

These methods can be shown to presuppose an implicit ontology of closed systems, resting on atomism and isolationism. And in opposing the mainstream orientation, I have elsewhere argued, heterodox economists have (implicitly at least) recognised that social reality is not closed and atomistic, but rather is open (not reducible to event regularities), structured (irreducible to actual human behaviour), intrinsically dynamic or processual (being continuously reproduced and/or transformed through practice), and highly internally related (consisting in features that are constituted by their relation to other features—for example teachers and students [and their obligations and practices] presuppose, and are constituted through their relationship to, each other) and so holistic, amongst other things. This latter conception of the nature of social reality has underpinned the heterodox traditions alternative approaches.

I might emphasise that my claim is not that heterodox groups normally recognise their ontological presuppositions, nor even the ontological nature of their opposition to the mainstream. Indeed one of the reasons I myself have been arguing explicitly for an ontological turn in economics is in order to encourage the implicit to be made explicit. But if this assessment of the implicit nature of ontological reasoning is correct it does not undermine the position I am defending.

Now if ontological criteria divide all heterodox groups from the mainstream they do not equally serve to divide the heterodox projects from each other—just because all heterodox projects seem implicitly to presuppose the same ontological conception of openness, structure, process, internal-relationality, and so forth. Rather as I have also argued elsewhere each heterodox position is best conceived as a division of labour within a relatively coherent overall (heterodox) project (Lawson, 20003a, Chapter 7).

Notice that in advancing this contention, I am suggesting that the heterodox traditions within economics relate to each other in much the way that economics relates to other social-scientific sub-disciplines. Because all the branches of social science deal with
similar material, specifically with social phenomena that are open, structured, dynamic, etc. then, (as with natural sciences dealing with their own common material) it is reasonable to interpret each sub-discipline (including economics) as a division of labour within one overall social scientific endeavour. I am adding to this that the separate heterodox traditions are best conceived as divisions of labour within economics.

The reason I reject the view that any heterodox tradition be identified according to substantive theories, methodological principles, policy stances and so forth is just because there is much disagreement on such matters within any given heterodox tradition as well as development of them overtime. If there is anything left over that can (and I believe does continually) unite each separate heterodox tradition as a coherent project within the wider heterodox programme, it is a continuing interest not with answers or principles but with a particular set of questions or interests. My task here, then, is to indicate the set of questions and concerns that most characterise the history of the institutionalist tradition.

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2) And I have argued in particular that economics is best conceived as the identification and study of the factors, and in particular social relations, governing those aspects of human action most closely connected to the production, distribution and use of the material conditions of well-being, along with the assessment of alternative really possible scenarios (see Lawson, 2003a, Chapter 6).

3) Thus, for example, Post Keynesians can be identified according to their concern with the fact of fundamental uncertainty stemming from the openness of social reality. Such a focus could take in the implications of uncertainty or openness for the development of certain sorts of institutions including money, for processes of decision-making, and so forth. At the level of policy the concern may well include the analysis of contingencies that recognise the fact of pervasive uncertainty, given the openness of the social reality in the present and to the future, etc. For those influenced by Keynes especially, a likely focus is how these matters give rise to collective or macro outcomes, and how the latter in turn impact back on individual acts and pressures for structural transformation, etc.

By similar reasoning Austrians may perhaps be best identified according to their emphasis on studying the market process and entrepreneurship in particular, or perhaps in line with the attention given by this project to the role of intersubjective meaning in social life, and so on.

Feminist economists already tend to identify their own project, namely as one that (in addition to proceeding very differently to the mainstream) concerns itself with women as subjects (which may include, for example, giving attention to differences amongst women, as well as between genders) and takes a particular orientation or focus, namely on the position of women (and other marginalised groups) within society and economy. The latter focus includes an attention to the social causes at work
In my view the concern that has traditionally and uniquely most taxed (and continues to tax) the old institutionalist tradition is how to deal with continuity and change, or reproduction and transformation, in social life. In particular, the old institutionalist tradition has pursued an interest in analysing continuity and change in the face of an open social reality (albeit not using this terminology) where continuity and change are ontologically on par, with each in need of explanation (albeit perhaps with some contributors seeing the explanation of continuity/stability the more challenging and others the explanation of change).

I might briefly note before continuing that if the conception of old institutionalism that I am here advancing is correct (and if recent arguments of modern realist social theorising concerning emergence are equally correct), a focus on ‘downward reconstitutive causation’ will doubtless be an important concern for modern institutionalists. But it will remain but one concern, and it is a feature of social being that warrants emphasis within institutionalism just as a result of the historically and conceptually prior concern to investigate the nature and causes of social change and continuity.

Now I further want to suggest that it is in the context of this concern with change and continuity and stability that the institution has been focussed upon, by institutionalists, as a significant aspect of social life, rendering the naming of the project as institutionalist coherent. Specifically, in a world of flux and uncertainty the institution has been regularly identified as a relied-upon source of endurability, of continuity and stability, and indeed as the most significant such source. And this fits with the conception of institutions that I have briefly given elsewhere, as particular social phenomena, mostly social systems, or structured processes of interaction, that are relatively enduring and recognised as such (See Lawson, 1997, pp. 317–318; Lawson, 2003a, pp. 43, 332).

Actually I need to modify this conception to capture the insight that some structures are actually set up as institutions, that is are formally instituted, but turn out to be short in the oppression of, or in discrimination against, women (and others), the opportunities for progressive transformation or emancipation, questions of power and strategy, and so forth. This orientation has inevitably meant a significant attention, within feminist economics, to issues which historically have been gender-related, such as caring, especially for children, and indeed the nature of family structures in specific locations. But in principle there is no area of social life that is excluded. It is the sorts of questions pursued that seems most to distinguish an approach within the heterodox traditions as feminist, not specific substantive claims or methodological principles.
lived. Such occurrences need to be acknowledged alongside the typically (though not necessarily) non-planned 'spontaneously' emergent forms that with time are found to be relatively enduring. So my modified conception of institutions is just that they are particular forms of emergent social phenomena, mostly social systems, or structured processes of interaction, that are either intended to be (whether or not they are), or are discovered a posteriori to be and are recognised as, relatively enduring.

**The Contribution of Veblen**

To defend my conception of old institutionalism (and very briefly the category of institution that best fits with this tradition), let me consider the central contribution of Veblen, surely the figurehead of the old institutionalist tradition, and the way Veblen's message was taken up by post-Veblenian institutionalists, specifically through their wielding of the 'Veblenian dichotomy' as a major tool of the institutionalist tradition.

Veblen's central concern is summed up in his formulating one of the most famous questions of economics: "Why is economics not an evolutionary science?" As I have argued elsewhere (Lawson, 2002, 2003a) Veblen clearly thought economics should become an evolutionary science (even though he believed, wrongly, that it was evolving into one anyway). By an evolutionary science, Veblen understood the concern with, and study of, (non-teleological) processes of cumulative change and causation. In the context of economics specifically Veblen opens his discussion writing:

"There is the economic life process still in great measure awaiting formulation. The active material in which the economic process goes on is the human material of the industrial community. For the purpose of [an evolutionary] economic science the process of cumulative change that is to be accounted for is the sequence of change in the methods of doing things—the methods of dealing with the material means of life" (Veblen, 1898, pp. 70–71).

And Veblen concludes his assessment writing

"... an evolutionary economics must be the theory of a process of cultural growth as determined by the economic interest, a theory of a cumulative sequence of economic

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4) Veblen attempted an evolutionary account of the rise to dominance (as he expected) of an evolutionary economics. For this reason he downplayed his preference for such an outcome lest his account be interpreted as teleological (and so not evolutionary at all). But his preference for the evolutionary approach is clearly in evidence in his writings (See especially Lawson, 2003, chapter 8).
institutions stated in terms of the process itself. ... It is necessarily the aim of such an economics to trace the cumulative working out of the economic interest in the cultural sequence. It must be a theory of the economic life process of the race or the community" (Veblen, 1898, pp. 77–78)

Various aspects of these passages are worth emphasising. Observe, first of all, that Veblen makes reference from the outset to the economic life process. By this expression I take Veblen to be concerned with the way human society and culture, and human-beings in society and in culture, develop or change overtime. Just as Darwin was interested in the history of all life regulated by ‘decent with modification’, so, I think, Veblen takes the goal of evolutionary social theory to be human socio-cultural history regulated though descent with modification. The second passage seems to conform this interpretation.

Of course, Veblen is focusing on economics. So his primary concern is with one aspect of this life process, namely the economic aspect. By economic Veblen means methods for dealing with (or actions concerned with, or interests in) the ‘material means of life’. So Veblen is concerned with socio-cultural evolution primarily as it connects to changes in the methods of dealing with the material means of life, basically technology.

The point I really want to draw out, though, is that Veblen is dealing with process, with change overtime. And as the second passage reveals an evolutionary theory must be “a theory of a cumulative sequence of economic institutions stated in terms of the process itself”. I want to suggest that institutions are mentioned here just because they are being interpreted as a relatively enduring feature of social life, albeit a feature that is subject to evolutionary change and development. Unfortunately, before I can establish this contention I must first deal with a prominent misreading within (old) institutionalism concerning Veblen’s notion of an institution.

There is a passage in The Limitations of Marginal Utility, much quoted by (old) institutionalists, and widely interpreted as in effect Veblen’s definition of an institution. According to this interpretation Veblen conceives institutions to be “settled habits of thought common to the generality of men”.

But now consider a rather more extended version of the passage from which the above ‘definition’ is extracted. The context is Veblen’s discussion of the “premises of marginal-utility economics”. At the relevant point of the discussion, in a passage that includes the suggested definition of an institution, Veblen is arguing:

“[these premises of marginal-utility economics]...are principles of action which underlie the current, business-like scheme of economic life, and as such, as practical
grounds of conduct, they are not to be called in question without questioning the existence of law and order. As a matter of course, men order their lives by these principles and, practically, entertain no question of their stability and finality. That is what is meant by calling them institutions; they are settled habits of thought common to the generality of men” (Veblen, 1909, p. 239).

Veblen immediately continues however:

“But it would be mere absentmindedness in any student of civilisation therefore to admit that these or any other human institutions have this stability which is currently imputed to them or that they are in this way intrinsic to the nature of things. The acceptance by the economists of these or other institutional elements as given and immutable limits their enquiry in a particular and decisive way. It shuts off the inquiry at a point where the modern scientific interest sets in” (Veblen, 1909, p. 239–240).

It is clear from the wider passage that Veblen is not here offering a definition of an institution in terms of habits of thought at all. Rather, in the often-quoted passage, the subject of the sentence is not even institutions but (certain) principles of action. By calling them institutions Veblen is drawing attention to their perceived “stability and finality”, on their being “settled” and “common to the generality of men”. Veblen is not offering a strict definition here, but is implicitly applying his understanding that institutions are in effect relatively enduring and widely recognised as such.

Consider, too, that part of the extract that immediately follows the familiar short excerpt. From Veblen’s suggesting it would be absentmindedness to “admit that these or any other human institutions have [the noted] stability”, it is apparent that he has been referring not to institutions per se, but rather to particular examples of social phenomena that might be called institutions.

What is more significant here is that Veblen is noting the degree to which stability is imputed to institutions. Veblen is not denying that their stability is but relative (to most other social phenomena); indeed he is explicitly emphasising that no social phenomenon can be treated as given or fixed. His more specific contention, though, is that if institutions are relatively enduring compared to other social phenomena, it is precisely institutions that are subject to processes of evolutionary change or adaptation overtime.

The Veblenian Dichotomy

Many institutionalists who took up this theme of theorising continuity and change did not always follow Veblen in insisting that institutions are, if relatively stable, also continually subject to change. Rather the analysis of continuity and change became
somewhat dichotomised, even being referred to as the Veblenian dichotomy. This, however, does not matter for my immediate concerns, which is to establish the traditional institutionalist concern is with questions of process, of reproduction and transformation. But let me go through some of it anyway, to indicate that the dichotomy in question is indeed as I have portrayed it.

Precisely put, the Veblenian Dichotomy is the idea that social life, or more specifically culture, is essentially decomposable into two aspects: technology and institutions. Or rather that it is decomposable into technology and the ceremonial features of life, where prominent amongst the latter are institutions. And these two components are interpreted as being different indeed. The former serves as a continuous internal impulse to change; the latter acts merely to constrain, to render everything static: without technology there would be no change.

Consider, for example, the writings of David Hamilton, in a book whose publication 50 years ago was recently year marked by a special symposium in the institutionalist Journal of Economic Issues. Hamilton raises the ‘enigma’ that social life, including especially culture, reveals both continuity and change, and wonders how this is possible. His explanation is simply that technology provides the latter while institutions impose the former, that once the distinction between technology and institutions is recognised the enigma to which he refers is clear:

"Once this distinction is clearly seen, the seeming enigma of the dynamic and static aspects of culture becomes clear. Culture is made up of dynamic and static elements that appear "in some sort of symbiosis". Veblen and other institutional economists call the static element institutions; the dynamic element is called technology" (Hamilton, 1991, p. 84)

As is well known, institutionalists who take the view described draw significantly on the (early) writings of Clarence Ayres in particular, for whom the following summary statement is perhaps characteristic:

"The history of the human race is that of a perpetual opposition between ... the dynamic force of technology continually making for change, and the static force of ceremony-status, mores, and legendary belief-opposing change" (Ayres, 1944, p. 176)

Now whatever we may think of the ‘dichotomy’ as portrayed by Hamilton, Ayres, and others, I think it is clear that the notion of an institution embedded in their analyses conforms to the conception of it I am defending: as expressing those features of social life that are relatively enduring and recognised as such. It is clear that Hamilton and Ayres, etc., go overboard with this notion and regard institutions not merely as relatively
enduring, but as more or less fixed over a significant period of time, after which they still
do not change but wither away (see Lawson, 2003b). As Veblen recognized, in reality
institutions undergo continuous processes of change, and are essential components of an
impetus to change elsewhere. But this discussion should be sufficient to drive home my
central claim that, for the institutionalist tradition, the concern has long been to develop
an understanding of social processes, to comprehend social life under its aspects of
relative continuity as well as change. And the notion of the institution has figured in this
just because it has been thought to provide a major element of continuity or durability
that arises in social life. Hence the sense of using the term institutionalism to indicate a
major concern, or central focus, of the project in question.

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