

The Decline of the ‘Original Institutional Economics’ in the Post-World War II Period and the Perspectives of Today¹

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Abstract

Original, or ‘old’, institutional economics (OIE) – also known as ‘institutionalism’ – played a key role in its early stages; it could be said that it was once the ‘mainstream economics’ of the time. This period ran approximately from the first important contributions of Thorstein Veblen in 1898 to the implementation of the *New Deal* in the early 1930s, where many institutionalists played a significant role.

However, notwithstanding its promising scientific and institutional affirmation, institutional economics underwent a period of marked decline that spanned from the mid-1930s to the late 1980s, when a new season for institutional economics was set in motion.

In order to cast some light on this complex issue – without any claim of completeness – we have organised the work as follows: in the first section we consider the main interpretations of this phenomenon. In the subsequent sections we analyse a number of ‘endogenous’ aspects which might have played a significant role in the period of decline: **(i)** the relations of institutional economics with Keynes’s macroeconomic theory; **(ii)** the links between theoretical and empirical analysis and the supposed lack of a clear theory; **(iii)** the interdisciplinary orientation.

Keywords: Original institutional economics, social valuation, political economy, interdisciplinarity

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1. The Decline of Institutionalism and the Main Existing Interpretations

The Ascendance and Decline of Institutionalism

Institutional economics originated in the United States in the first decades of the 20th century. Its cultural roots can be identified in the philosophy and psychology of Pragmatism – in particular in the theories of Charles Sanders Peirce, John Dewey and William James – and in the German historical school, whose principles were developed by the scholar, Richard T. Ely, who had a considerable influence on the formation of the first generation of institutionalists.

The main founders of institutional economics were Thorstein Veblen, John Rogers

¹ This paper is a development of work originally published in a chapter of my book, *The Systemic Nature of the Economic Crisis: The Perspectives of Heterodox Economics and Psychoanalysis*, London and New York, Routledge 2015; and, in Italian, in the journal *Il Pensiero Economico Moderno*, 2015 (4). In the present version all the sections have been substantially broadened (and one more, the fourth, added) in order to develop more fully the issues addressed. In particular, the sections related to the central theme of the relations between theoretical and empirical analysis have been totally re-elaborated.

Commons, Walton Hale Hamilton, Wesley Clair Mitchell and Clarence Ayres. Relevant contributions were also made by L. Ardzooni, A.A. Berle, J.C. Bonbright, J.M. Clark, M.A. Copeland, J. Fagg Foster, I. Lubin, Gardiner C. Means, Walter Stewart and many others.

Significant contributions with important connections to institutional economics were provided by, among others, John Kenneth Galbraith, Fred Hirsch, Albert Hirschman, Gunnar Myrdal, Karl Polanyi and Michael Polanyi.

Within institutional economics, two main strands² can be identified: **(i)** the *Original (or Old) Institutional Economics* (OIE), formed by the first institutionalists and by subsequent scholars who shared their main concepts; and **(ii)** the *New Institutional Economics* (NIE), which was born in the post-WWII period, composed of economists adopting principles mainly related to the Neoclassical and Austrian schools.

In this regard, it is interesting to observe the significant links between the OIE and, among others, the following theories: **(a)** various strands of sociology and social psychology, including the “Sociological or Ecological School of Chicago”, the social psychology of William James and of William Ogburn; **(b)** a number of theories of technological innovation, often referred to as neo-Schumpeterians, which share important concepts with the OIE: for instance, the importance of path-dependency processes in explaining the characteristics of science, technology and innovation in any given context.

The pivotal concepts characterising the OIE can be summarised as follows: ceremonial/instrumental behaviour, instincts, culture, evolution, habits, path-dependency, tacit knowledge, power, technology, collective action, social provisioning, market imperfections, social planning, working rules and social valuing. As noted by numerous authors, the OIE does not present a completely unitary framework. Within this ambit, two main strands can be identified:

- i. An approach (the Veblen-Ayres tradition), stressing the dichotomy between ceremonial and instrumental institutions; the role of habits of thought and action; the cumulative character of technology in its relations with workmanship and parental bent propensions.
- ii. An approach put forward in different ways by J.R. Commons, W.H. Hamilton and W.C. Mitchell., which centres on the evolutionary relations between the economy, law and institutions; the nature of transactions, institutions and collective action; the role of conflicts of interest and the social valuing associated with them; the theoretical and empirical analysis of business cycles and their relations with institutional setting and policy action; and the role of social psychology for understanding economic and social phenomena.

Notwithstanding a number of differences between (and within) these approaches, the elements of convergence are remarkable. In our view, the observed differences tend to be concerned more the issues addressed than in the basic aspects of the OIE.

Within this conceptual framework, OIE stresses that the presence of an institutional context – with its values, norms, conflicts, organisations, routines, habits and customs – constitutes a necessary factor for understanding the human activity of social provisioning. In other words, every economic action embodies, at the same time, a social, institutional, historical and psychological dimension. Thus, an understanding of economic actions demands a joint analysis of all these dimensions which, for this reason, necessitates the adoption of an interdisciplinary approach.

² As clarified in the introduction, in this work we do not address the relations between OIE and NIE but concentrate our attention on the factors underlying the evolution of the OIE.

In extreme synthesis the leading ideas of the OIE are the following: **(i)** the belief in the complex and interactive character of 'human nature', and the consequent importance of the social and institutional framework for its amelioration; **(ii)** the refusal of any abstract and deductive theorising detached from the observation of reality, and the consequent emphasis on inductive methodology based on case studies and statistical analysis; **(iii)** the importance attributed to the notion of 'social control' – meaning the proactive role of institutions and policies in addressing economic and social problems; **(iv)** an interdisciplinary orientation – in particular with the philosophy and psychology of pragmatism and other related contributions of social psychology – in order to acquire a more realistic account of the characteristics of human nature in its individual and social unfolding.

These ideas had their origin in important universities – in particular, Amherst, Chicago, Columbia, Wisconsin, which were associated with various strands of OIE – which became the springboard of collaborations with numerous research institutions and governmental bodies.

The general sentiment pervading these initiatives was one of optimism about the possibilities of social progress. Such orientation was by no means confined to institutional economists as it involved the philosophy and psychology of pragmatism, and various strands of psychology, sociology and political science.

In this context, OIE played a relevant role in its early period, and it can safely be said that it came to be, although perhaps only by a slight margin, the 'mainstream economics' of the time. This period ran approximately from Veblen's first important contribution in 1898 – the article 'Why Is Economics Not an Evolutionary Science?' – to the implementation of the *New Deal* in the early 1930s, where many institutionalists played a significant role.

So after such a popular period for OIE, the question poses itself, what are the main causes of its subsequent decline? As noted by a number of contributions (see, for instance, Hodgson, 2004; Myrdal, 1972; Rutherford, 2011), one relevant factor that triggered the decline of institutional economics was the eruption of the Great Crisis of 1929. But how relevant was this? The answer is two-fold: **(i)** institutionalists were unable to forecast the eruption of the crisis; **(ii)** the proposed remedies for the crisis were (or, at least, seemed to be) not as path-breaking as those advocated by Keynesian exponents. As regards the first point, it is true that in the period before the crisis, economists (neoclassical, institutionalist, and otherwise) were neither able to predict the crisis nor, shortly after its onset, to fully grasp its structural and far-reaching dimension. As regards the second point, the picture is more complex. In fact, many institutional economists provided significant suggestions³ for overcoming the economic crisis. These suggestions centred on the role of market power and sticky prices in creating a high margin of profits and an unfavourable income distribution for working classes which, in turn, led to their insufficient capacity to consume. This situation was not counteracted by new investments, as a large part of the profits was saved or invested in financial activities.

In policy action – and in particular in the framing of the *New Deal* – institutional economists⁴ played an active role. Their proposals centred on realising some forms of economic planning, with a view to reduce mark ups and so obtain prices more oriented to costs. In this way, a more equitable distribution of income could ensue, which would steer a parallel increase in citizens' capacity to consume. In addition to policy changes, a number of institutionalists also proposed a programme of public works, but the widespread feeling was

³ See in particular Rutherford (2011).

⁴ See in particular, Berle and Means (1932); Levin, Moulton and Warburton (1934); Mills (1936); Moulton (1935, 1943); Nourse (1944); Nourse and others (1934); Tugwell (1924); Tugwell and Hill (1934).

that a high level of a public budget deficit and public spending would ‘crowd out’ private initiative in the middle to long run.

This was partly true, but, as the arguments employed by institutionalists partly resonated with neoclassical theory, they conveyed the impression, no matter how well founded, that their policy proposals were not sufficiently innovative to really lift the economy out of crisis. This impression was reinforced, as we will see presently, by a rather sceptical attitude of many institutionalists towards Keynes’s theory.

For this reason, since the kind of economic planning advocated by institutionalists was applied only to a limited extent and that a significant part of the *New Deal* was focused on public spending – and as the policy of public (and deficit) spending was considered an eminently Keynesian innovation – the main merit of this programme was attributed to Keynesian theory.

Another related aspect that contributed to OIE’s decline was the parallel strength, not only of Keynesian economics, but also of more orthodox fields of economics. As we know, in the late 1930s and even more so in the post-WWII period, there came about a massive development in the field of ‘micro-foundations’ of economic action. This was also realised through the development of the ‘New Institutional Economics’ (NIE) which, while recognising the importance of institutions, tended to interpret their functioning through the lens of the rational agent model.

These more ‘orthodox’ contributions formed a kind of ‘alliance’⁵ in the post-WWII period between economic models based on an extensive use of mathematics and econometric techniques trying to ‘validate’ the underlying hypotheses. This is not the place for detailed assessment of these models except to say that while often focusing on important aspects of economic action, they are trapped in the typical shortcomings of a positivist methodology, namely reductionism and simplification. The approach of the OIE, however, allows for a more thorough analysis of concepts like market imperfections, agency and expectations that, although more developed in the ‘mainstream’ domain, have strong institutional foundations. So, as we will try to show, the crisis of institutional economics can be traced back to these mathematical or ‘scientific’ approaches which set an over-arching agenda for economics.

The Main Interpretations of the Institutionalism Decline

According to Geoffrey Hodgson (2004), the weak aspects of institutionalism lie in the different opinions of its exponents on many issues:

- (a) The prevalence in the post-WWII period of the Ayres’ tradition had a negative effect on the development of OIE. This came about for two reasons: (i) the emphasis placed by Ayres – who followed a narrow interpretation of Veblen’s analysis – on the ‘always progressive role’ of technology and the ‘always negative character’ of institutions appraised only as a ‘ceremonially-based’ obstacle to economic and technical progress; (ii) the abandonment, in the Ayres’ tradition of the OIE, of the analysis of prices and of microeconomic relations in favour of a faith in progress based on a kind of technocratic determinism. As a result, OIE lost interpretative power of many relevant phenomena.
- (b) The lack of agreement on the ‘fundamentals’ of institutional economics: these are, in Hodgson’s words, ‘the necessity of “metaphysical presuppositions” for theory, the principle of determinacy, the degree of emphasis on human agency or volition, the degree

⁵ For more details on this process refer to Yonay (1998)

of application of Darwinian principles to economics, the recognition of the enabling as well as the constraining possibilities of institutions, the degree of acceptance of Jamesian instinct-habit psychology, and the degree of accommodation to behaviourist psychology' (Hodgson, 2004, p. 393).

- (c) These problematic aspects were reinforced by the abandonment of a 'truly Darwinian programme' from Veblen and even more by his followers who, in Hodgson's view, adopted only a mild version of evolutionism.

Malcolm Rutherford (2011), in his reconstruction of the institutionalist movement in America during the period 1918-1947, provides a different account for the OIE's decline. He argued that OIE did not fulfil its intention to provide a strong psychological foundation to its theoretical framework. There were attempts made, but they were rather fragmented and rarely went beyond the stage of acute intuitions. This situation was reinforced by a similar situation in psychology (see also later).

Another reason for OIE's decline was that the theory of business cycles, despite its relevant developments, remained in a rather confused state at theoretical and policy level.

In fact, the comprehensive work of Wesley Mitchell on business cycles, while contributing with factual data to detect their complexity and unpredictability, did not provide a clear theoretical explanation for their evolution. This opened the door to the massive attack on institutionalism as being 'a narrative without a theory'. In Rutherford's words,

'Perhaps the most important displacement of all [of institutionalism] was that produced by the arrival of positivist ideas of science. These ideas allowed Keynesian and neoclassical economists to successfully adopt the mantle of scientific method while characterizing institutionalism as naïve empiricism... Under these circumstances, institutionalism could maintain little of the appeal that it had in the early 1920s... The rhetoric of science had been taken over by Keynesian and neoclassical economics supported by econometric methods, and the ideas of social control had been adapted and rebranded by those associated with Keynesian policy and the welfare state. Indeed, the appeal of Keynesian economics was, at base, exactly the same appeal to science and social control that institutionalism had held out previously, and generated the same enthusiasm and success' (Rutherford, 2011, p. 353).

An aspect of this shift was the growing formalisation of economics which, according to Morgan and Rutherford (1998), was chiefly to be ascribed to the rise of McCarthyism in the early post-WWII period. In their words, 'The cold war enforced, if it did not create, the trend toward economists offering professionally neutral, objective expertise, which contrasted strongly with the ethical, and strongly held, advocacy of the late-nineteenth-century professional economist' (Morgan and Rutherford, 1998, p. 16).

While agreeing with most of the aspects underscored by the previous studies, we also think that there are a few less convincing aspects. As for Hodgson, the role attributed by him to Darwinism in economics seems a bit one-sided. True, some Darwinian concepts can help understand the characteristics of socio-economic evolution, but it also seems true that our behaviour cannot be reduced to only a biological metaphor. In fact, human behaviour is much more open than that of animals to the manifold influence of cultural conditions. For instance, it is easily observable nowadays in western countries a relative decline of jazz music from its golden time, with a parallel rise of various versions of pop music. True, the

application of Darwinian concepts of struggle for survival, replication, selection and evolution can help understand the dynamics of this phenomenon. However, we should not forget that we are dealing only with a metaphor, for the simple reason that, in the example, the evolution of musical tastes has little to do with any 'objective necessity' related to the imperatives of 'natural selection'. Conversely, such evolution constitutes an utterly cultural phenomenon which can find different expressions in various contexts. The same applies, of course, to many other economic and social issues.

Also technological progress, for instance, does not show a deterministic pattern but is heavily 'embedded' in the economic and social structure. An interdisciplinary approach, however, can help attain a more far-reaching understanding of these phenomena.

With respect to Hodgson's stress on the negative role of the abandonment of the theories of pricing, we can note that a tradition in this respect existed in institutionalism. A tradition that began with the seminal contributions of J.R. Commons and W.H. Hamilton, who elaborated central concepts for the theory and policy of competition, industrial relations and public utilities regulation. They detailed, for example, the legal foundations of transactions, markets and competition, the notion of reasonable value and due process of law, and the complex character of policy action.

Therefore, even if we agree that the Veblen-Ayres' tradition can have, in some way, weakened the focus on microeconomics, we believe that the critical factor for the crisis of institutionalism rests, as also underlined by Hodgson, on an insufficient clarification of the central aspects of method and theory. And that such weakness left OIE relatively defenceless against the increasing adoption in the profession of a positivist stance, which found expression in the widespread employment of a maths and econometrics.

As for Rutherford's analysis, we think that, in dealing with Keynes's approach, it mainly rests on a quite simplified account of his theory as a mere advocacy of deficit spending. We believe that a distinction needs to be made between three aspects: **(i)** the complexity of Keynes's macroeconomic theory; **(ii)** the subsequent neo-Keynesian developments most often including neoclassical elements; and **(iii)** the simplified account of Keynesian theory in public debate as a mere advocacy of deficit spending. Regarding point (iii), as we will see presently, Keynes remarked that large deficits cannot be considered a permanent solution for economic imbalances.

We also agree with Morgan and Rutherford's account of the role of McCarthyism in pushing forwards a growing formalisation in economics. However, we think that other explanations are also required for casting light on the rise of formalism in economics and the parallel decline of institutionalism in the post-WWII period.

This is because this formalistic trend is by no means confined to the McCarthyism phenomenon. In fact, **(i)** this trend continued in the USA even throughout the more progressive decades of the 1960s and 1970s, and it is still apparent now; **(ii)** it extended well beyond the USA to become a worldwide phenomenon; **(iii)** it constituted a typical aspect not only of the orthodox domain, but also of various fields of heterodox economics (for instance, various streams of radical Keynesianism and Marxism).

Hence, the great importance ascribed to formalism can be regarded as an aspect of the general affirmation, as also stressed by Rutherford (2011), of a positivist trend in social sciences. It would seem that what lost ground in the post-WWII period was a *humanistic* perspective in economics and other social sciences, and this constituted a major factor in the decline of the OIE's perspective.

We think that one explanation for this loss of humanistic perspective can be that in this period there was a (more or less conscious) belief that the advances achieved in natural and technical domains could be automatically transposed to social sciences. This factor can

also explain why the positivist drift was also strong in the early 20th century (see also later) and is still present today.

The issue remains, however, as to the 'endogenous reasons' that rendered the institutionalist reaction to this shift ineffective. We will consider three factors which can help explain the OIE's decline: **(i)** the relations of institutional economics with Keynes's macroeconomic theory; **(ii)** the links between theoretical and empirical analysis and the supposed lack of a clear theory; and **(iii)** the interdisciplinary orientation.

2. Original Institutional Economics and Keynes's Macroeconomic Theory

In general, although with a number of exceptions, institutional economics has never had much enthusiasm⁶ for Keynes's macroeconomic theory (in particular, 1931 and 1936). In fact, the key message conveyed in Keynes's theory (simplifying greatly) was that the best way to push the economy was through public spending and deficit spending. And, furthermore, that large deficit could be maintained over time without much damage to the economic system.

In relation to this simplified interpretation, many institutional economists were rather critical and skeptical of Keynesian theories. Most of them remain unconvinced of Keynes's macroeconomic approach which, in their views, did not consider the variety of microeconomic aspects and, in particular, they underscored the danger of a policy of deficit spending⁷ on the inflation rate and on the crowding out of the private sector.

This, of course, does not mean that the OIE paid little attention to macroeconomic issues. In fact, it is worth stressing that many economists belonging to institutionalism (or to fields close to it) provided relevant empirical and theoretical contributions to macroeconomic imbalances. We can mention: **(i)** the contributions to the issue of business cycles provided by Veblen and Mitchell, and the analysis of the relevance of macroeconomic stability expounded by John R. Commons; **(ii)** the important but rather neglected field of underconsumption; **(iii)** the macroeconomic approach of, among others, Alvin Hansen and M. Ezekiel, which have various parallels with Keynes's theory.

However, notwithstanding this progress, it seems safe to say that the dialogue between institutional and Keynesian economists has not been very effective from either side. The weak aspect of the institutionalist attitude does not lie in pointing out the limitations of Keynes's theory, but in not fully grasping, on the one hand, the inadequacy of mainstream 'macroeconomics' based on 'Say's law' and, on the other, the challenge posed by the Keynesian approach that, although flawed by some weak aspects⁸, goes well beyond a simple advocacy of deficit spending. In fact, Keynes's theory did nothing less than to build, virtually from scratch, the modern macroeconomic theory. As a matter of fact, before that time, no real macroeconomics existed at all. As is known, both classic and neoclassic economics strictly adhered to the so-called 'Say's law', according to which aggregate supply 'automatically creates' its own demand. If economic systems worked like this, no macroeconomics would be needed at all, since the sum of the individual behaviour (in particular, consumers and firms) would explain the aggregate outcome.⁹

⁶ See also Rutherford, 2011, ch.10.

⁷ In this regard, Keynes remarked that large deficits cannot be considered a permanent solution for economic imbalances. In his view, what was needed for a structural solution of economic imbalances is a combination of macroeconomic and structural policies (see also later) able to reduce the tendency of economic systems to get easily trapped in under-employment equilibria.

⁸ We have addressed in more detail the main aspect of Keynes's macroeconomic approach, also in relation with the theories of underconsumption, in Hermann (2017).

⁹ It can be interesting to note that it has been the adherence to such 'law' that has permitted 'the logical shift' from classical to neoclassical economics. In fact, classic economics, although relying on the

In this world, optimisation and economic progress would proceed in tandem, provided that the market was let to work free from interferences from the public sector.

This picture was completely reversed by Keynes's theory (and also by theories close to institutionalism, such as those of underconsumption¹⁰). While his theory assumes a reasonable 'perfection' – or, at least, no major imperfections – of markets at the microeconomic level, it also explains how the macroeconomic outcome can easily be at variance with an optimal allocation of resources. This is due to the structural tendency of aggregate demand to lag behind aggregate supply.

The main causes of this phenomenon are **(a)** a relatively low level of propensity to consume, which can be traced back to wide differences in incomes, since the propensity to consume for higher incomes is likely to be less; and **(b)** the effects of technological progress which, by tending to make many jobs redundant, require an increasing aggregate supply in order to secure a full employment level.

This is, however, not the end of the story, as at the least three other factors should be added for 'closing' such macroeconomic system: **(i)** the tendency of nominal wages to lag behind the inflation rate, with a consequent diminution of real wages;¹¹ **(ii)** the dynamics of real interest rates, their dependence upon monetary policies and their (negative) effects on the expected profits of firms (or marginal efficiency of capital, MEC); **(iii)** the role of 'animal spirits', namely, the tendency of persons to embark on economic initiatives not so much on account of the prospective returns, but owing to an instinctive proclivity to action.

These aspects mainly pertain to the short-term, so we should also add Keynes's analysis of the long-term perspectives in economy and society, which was developed in particular in the *Essays in Persuasion*. Here he explained how focusing attention on short-term problems constitutes only a part of a more profound awareness of the structural transformations of society. The full unfolding of these tendencies can open up new avenues of progress, in which the 'economic motive' associated with the more negative traits of capitalism – selfishness, greediness, avarice – can gradually become unimportant and be replaced by social and cooperative relations.

Keynes was also fully aware – by making explicit reference to Commons's taxonomy – of the transformation of individual capitalism into a 'concerted capitalism', in which the role of public action, also in the form of semi-autonomous agencies, would play a pivotal role.

Turning to our theme, this forward-looking and articulated theory – which, of course, needed to be developed in various respects – was partly overlooked by institutional economists, as they tended to consider a simplified version of it. Relatedly, the same holds true for Keynesian economists, who paid little attention to institutional theories.

The result of this gulf between the two groups caused a delay in better clarifying fundamental aspects of the economic systems that would have benefited from a more systematic collaboration between these theories. We can mention, in particular, the following intertwined aspects: **(i)** the role of legal and institutional frameworks in promoting a balanced economic and social development; **(ii)** the role of public spending and credit creation in the

hypothesis of perfect markets, is still constructed through the identification of neat social classes (in particular, workers and capitalists), whereas in neoclassical economics there exist only economic agents.

¹⁰ These economists (in particular, J.A. Hobson, A.F. Mummery, W. Catchings and W.F. Foster) stressed, in different ways, that one source of economic stagnation is the insufficient capacity to consume of the working classes, which is accompanied by an excess of saving by wealthy individuals and by corporations.

¹¹ This diminution performs, in Keynes's analysis, a complex effect: in fact, if, on the one hand, a reduction in the cost of labour can incentivise investment, on the other hand, the reduction of real wages can reduce effective demand, also because the propensity to consume is likely to be higher with lower incomes.

formation of effective demand; **(iii)** the links between macroeconomic and structural policies; **(iv)** the nature of expectations; **(v)** the manifold expression of market imperfections and their relations with social structure.

3. Relations between Theoretical and Empirical Analysis

One motive of the ascendance of institutional economics lies in its claim to be more concerned with investigation into the facts and data of the real world. This world, and in particular the economic domain, was becoming more and more complex and was characterised, along with the emergence of the modern corporation, by a growing importance given to market imperfections. Neoclassical economics, with its abstract¹² and deductive theorising, was considered unfit to adequately address these new phenomena. Hence, a novel approach was needed, and institutional economics seemed ready to take up the challenge.

As noted above, institutional economists became deeply involved in many relevant issues, such as labour legislation, structure of costs and prices, business cycles, antitrust policies, public utilities regulation, public works and other areas of public intervention. As noted by Rutherford,

‘All of this [activity] seems to indicate the strength of the institutionalist movement. Well established at leading universities and research institutes, with excellent access to external funding sources, involved with important government legislation and programs, and linked to recent developments in related disciplines. In all of these respects, institutionalism had as much or more strength than neoclassical economics.... Nevertheless, when Wisconsin and Columbia resumed hiring in 1946-1947, it was not institutionalists who were hired, but Keynesians and neoclassical economists, indicating that some very significant shifts in the academic environment must have taken place between the 1930s and 1946-1947 when hiring resumed’ (Rutherford, 2011, p. 350).

Thus, the question poses itself once more: why did this decline occur in spite of the highly relevant orientation of institutional economics? One reason, as we have just seen, was constituted by the affirmation of Keynesian economics. But this was by no means the sole cause. In fact, another and related reason for such decline rests in the unclear and often contradictory way in which institutional economics addressed the central issue of empirical analysis.

In order to better develop this issue, let's have a closer look at the methodological underpinnings of empirical work carried out by institutional economists. This work went along three main avenues: **(i)** statistical analysis of the main economic categories (consumption, investments, profits, prices) at various levels of disaggregation, in order to enquire into the dynamics of business cycles and the characteristics of industrial sectors; **(ii)** analysis of the legislation and court decisions, with particular reference to the issues of industrial and competition policies, and of public utilities regulation; **(iii)** case studies related to particular firms, industrial sectors and other economic realities.

¹² As noted before, in this period neoclassical economics had not yet established a systematic collaboration with econometrics.

These activities were flourishing and produced significant results, but something stood in the way to hinder their full unfolding. As noted before, this was due to the massive development, in the post-WWII period, of mathematical models and econometric analysis on the part of both neoclassical and various strands of the new Keynesian economics.

Of course, mathematical models and econometric models are quite different things – a mathematical model might not be amenable to econometric analysis and we can perform econometric estimates without a clear model, mathematic or otherwise, underlying them – but in the widespread opinion both were considered as a step towards a more ‘scientific and objective way’ of investigating the economic phenomena. In fact, mathematical models, whether or not allowing econometric estimates, were constructed as ‘a piece of theory’ amenable, actually or at least potentially, to empirical testing. The philosophical basis of this development was positivism, which formed from a narrow conception of behaviourism.

The institutionalists’ reaction to these events was largely ineffectual, because they partly shared (at a higher or lesser degree) a kind of positivist¹³ attitude. For this reason, notwithstanding their relevant contributions on all the three headings (i) to (iii), they only considered statistical analysis to be truly ‘empirical and scientific’ (the heading (i) above).

In this regard, their philosophical background oscillated between pragmatism and positivism, and was never sufficiently clarified. In fact, they adopted John Dewey’s notion of behaviourism, but this was often intermingled with a positivist notion of behaviourism. However, these notions are very different and should not be confused, as they relate to the following aspects:

(A) The pragmatist conception of behaviourism – especially in the perspectives of John Dewey and William James – refers to the importance of analysing the ‘experience’ of a person in its entirety. Hence, we should consider not only the more directly observable and ‘measurable’ behaviour, but also the whole set of feelings and orientations in their individual and collective dimension.

(B) In the positivistic conception, only directly observable behaviour is considered ‘scientific’, because, it is claimed, only this kind of behaviour can be ‘measured’ in a more neutral and objective way.

These notions carry very different implications for social analysis. We can see this with a simple example: let us suppose we are investigating child behaviour at school. Following a positivist orientation, the researchers will try to find a set of factors which identify the ‘normal’ or ‘optimal’ behaviour at the school – for instance, the rate of attendance and the level or proficiency – and then they will proceed to estimate, by a variety of statistical and econometric techniques, the degree of fulfilment of these objectives.

Conversely, pragmatist oriented researchers would probably carry out the same kind of analysis, but would not stop there. Their results would not be the end of the story, but would constitute only the basis for further investigation into the individual and social factors that lead to a certain behaviour.

In fact, if we are studying children’s behaviour, we should not forget that we are dealing with persons living in a social context. Hence, in order to get a more complete assessment of the ‘normality’ of their behaviour, we should ideally get a profile for each child’s

¹³ Of course, this did not apply only to OIE but was a relevant aspect of social and psychological sciences in the early 20th century. One explanation might be that there was a (more or less conscious) widespread idea that the advances achieved in natural and technical domains could be automatically applied to social sciences. As already noted, this can also explain – along with other more ‘endogenous’ factors – the tendency towards a growing formalism in economics in the post-WWII period.

personal life, with the related emotions and conflicts. This study would also involve the main characteristics of the child's family and social relations, and of the social and institutional framework surrounding each child. For instance, social classes and groups and the organisation of education, with all their values and conflicts.

Needless to say, we are aware of the difficulty of such analysis and of the expediency of identifying single parts in a complex phenomenon. Within this ambit, it can be useful to look for correlations between aggregate phenomena, namely, between phenomena involving a collective dimension.

However, we should be aware that every generalisation involves a simplification, in the sense that many other factors are left out. This applies especially when we try to establish a causality between factors in order 'to demonstrate' the validity of a theory.

In this regard, it is pertinent to remark that aggregate analysis, however important, cannot become a substitute for a more comprehensive study of each person (and situation) considered. For this reason, as we will see, a plurality of methodologies is needed in order to carry out a comprehensive empirical analysis.

In facing these issues, institutionalists did not clearly identify and confront the various meanings of empirical analysis. They swung between a (relatively) uncritical endorsement of positivist methodology and an advocacy of the importance of a far reaching approach whose application, however, remained largely below its potential.

If we consider that this came about when neoclassical and Keynesian economics – and, later on, other fields significantly related to neoclassical economics such as public choice, new institutional economics and new regulatory economics – were investigating a number of relevant phenomena (in particular, macroeconomic imbalances, market imperfections, the role of public action and of interest groups) the reasons for the crisis for institutionalism appear clearly.

A good strategy for institutionalists to cope with this challenge would have been for them to chart an open and thorough confrontation on the various theories dealing with these issues. For instance, discussing the hypothesis of rational economic behaviour, institutional economists can point out that economic incentives can be important in some circumstances but cannot be reduced to the maximisation behaviour implied in the neoclassical conception of *homo oeconomicus*.

In fact, as underscored by various groups, a host of psychological and social factors are likely to enter the picture in the motivation of economic action. For this reason, the quest for money can indicate not only a desire for money as such, but also a need to gain social approval by following a socially accepted behaviour.

In order to thoroughly address these aspects, the empirical analysis would require a plurality of methodologies. In this sense, statistical and econometric estimates should be coupled with case studies, historical analysis of larger contexts, focus groups on particular problems, in addition to obtaining a more active involvement of the actors implied.

One relevant consequence of this broadened enquiry is that it would lead to a more pluralistic interpretation of the examined phenomena. In fact, considering these phenomena in their real complexity would make it easier to engage in a comprehensive confrontation of different explicative theories.

A possible drawback of this methodology – pointed out in particular by mainstream economists – is that, by putting too many factors in the basket, it would engender uncertainty and confusion. This is true in a degree but, at the same time, it is largely overstated. In fact, complexity does exist, and trying to disregard significant factors in order to simplify the picture would run a double risk. Not only of omitting a number of factors, but also of not making clear the underlying criteria and values of the researcher.

In this regard, what is needed for clarifying the criteria and values employed in the analysis is a thorough process of social valuing. A central aspect of this more comprehensive analysis relates to the interdisciplinary orientation of institutional economics.

4. 'Data without Theories' versus 'Metaphysics Driven Theories'

The title of this paragraph refers to the harsh polemic that arose¹⁴ between neoclassical and institutional economists over the theoretical foundations of the discipline. This debate centred around Mitchell's Presidential Address¹⁵ before the American Economic Association in 1924. Let us now briefly address the main contents of this controversy.

The View of Wesley Clair Mitchell

In his address he started by stressing the complementarity existing between the 'qualitative analysis' — which he relates¹⁶ in particular to the work of neoclassical economists regarding the 'utility function' of an individual — and the quantitative analysis of more objective factors, like prices and quantities in the market.

However, in Mitchell's opinion, as qualitative analysis cannot directly demonstrate whether individuals really maximise their utility, it becomes more expedient to employ and develop the techniques of quantitative analysis. In this way, by obtaining more information on a set of aggregate economic phenomena — for instance between prices and quantities — some interesting 'inferences' can be made about the behaviour of economic agents considered as a group. In his words,

'It seems unlikely that quantitative workers will retain a keen interest in imaginary individuals coming to imaginary markets with ready-made scales of bid and offer prices. Their theories will probably be theories about the relationships of variables that measure objective processes... the "psychological" element in the work of these men will consist mainly of objective analysis of the economic behaviour of groups. Motives will not be disregarded, but they will be treated as problems requiring study, instead of being taken for granted as constituted explanations' (Mitchell, 1925, pp. 26-27, quoted from W. Mitchell *The Backward Art of Spending Money and Other Essays*, New York, Kelley, 1950).

We can note that Mitchell's position, however innovative in many respects, is weakened by a kind of positivist stance according to which only 'measurable' phenomena are amenable to

¹⁴ For more detail on these aspects refer to Rutherford (2011) and Yonay (1998).

¹⁵ This took the form of an article 'Quantitative Analysis in Economic Theory', Presidential Address delivered at the 37th Annual Meeting of the American Economic Association, held in Chicago, December 1924. It was then published in *American Economic Review*, vol XV, pp.1-12, March 1925. This was followed by a rejoinder 'The Present Status and Prospect of Quantitative Economics', Round Table discussion at the American Economic Association meeting, December 1927, reprinted in *American Economic Review*, vol. XVIII, supplement, pp.39-41, March 1928.

¹⁶ Actually, neoclassical economics is based on 'pre-defined postulates' that render difficult a scientific enquiry into the whole set of measurable and non-measurable aspects that combine to explain the links between individual and collective behavior. In this regard, the institutionalist perspective seems much more fitted to address these issues. This is because OIE — and the same can be said for related disciplines like the pragmatism of John Dewey and William James, humanistic and social psychology, and psychoanalysis — arrives at certain (provisional) conclusions on, say, the types and degree of 'rationality' of economic agents, on the basis of a continual analysis of real phenomena.

scientific verification. This can be seen in the following passage where, after stressing that 'motives will not be disregarded', he adds,

'Psychologists are rapidly moving toward an objective conception and a quantitative treatment of their problems. Their emphasis upon stimulus and response sequences, upon conditioned reflexes; their eager efforts to develop performance tests, their attempt to build up a technique of experiment, favor the spread of the conception that all of the social sciences have a common aim — the understanding of human behaviour; a common method — the quantitative analysis of behaviour records, and a common aspiration — to devise ways of experimenting upon behaviour '(Mitchell, 1925, quoted: p. 27).

The Neoclassical Rejoinder

The neoclassical answer was that theories should be constructed independently of real data, in particular those having a supposed 'narrative character'. In this sense, theory should guide the empirical analysis, and not the other way round.

Building on this, neoclassic exponents sharply attacked institutionalism as a discipline without a theory, mainly based on data gathering. This can be true to a degree — owing to the above mentioned limitations — but it is also true that neoclassical position is quite weak. In order to see the shortcomings of neoclassical methodology, let us quote some passages from the Norwegian economist, Ragnar Frisch,

'Let us imagine a scientist who is watching the shifting aspect of the surface of water. An empirical description of the ups and downs of the surface of the water would not lead anywhere, however minute the description was. In order to gain a real understanding of the phenomenon, our scientist would have to introduce at least three different sets of *ideas*: first, the idea of direct action of wind on the surface of the water. This would account for small waves. Next, the idea of propagation of long swells coming from the ocean. And third, the idea of ebb and flow caused by the attraction of the moon. Without introducing a model world containing these three kinds of waves, he would be hopelessly lost in his attempting at understanding the phenomena... Or... Let us imagine that somebody wanted to explain the movement of the moon around the earth, and in order to do so, obtained the co-operation of a number of observatories on the earth. The observations obtained in this way would be interesting enough in themselves, but they would not contain any significant contribution to the problem at hand: the explanation of the orbit of the moon. The man who indicated the road to a real explanation of the phenomenon did it without any telescopes. His tools were just a pencil and a sheet of paper, and his name was *Isaac Newton*. In his imaginative mind he constructed a model world where bodies attracted each other with a force proportional to the masses of the bodies and inversely proportional to the square over their distance....The real discovery was brought about by a brain, not by a staff of patient observers. It seems to me that much of the work which has been done in economics in the recent years in its significance is comparable to minute observations of the surface of the moon in order to find out its orbit' (Frisch, 2011 [1930]).

Further Remarks

What can we say about such controversy?

We agree on the need to provide theoretical foundations to the phenomena under examination, but believe R. Frisch's remarks are rather ungrounded. It is untrue that, in the examples, these 'laws' have been construed by an abstract deduction based on an abstract reasoning. Quite the contrary, these laws have been inferred inductively from a careful observation of reality. Accordingly, we can note that Newton himself derived the law of gravitation from induction, namely, from observing natural phenomena. And that, from Newton's time onwards, such law and its underlying theory have been (and are being) more and more refined and clarified as a result of a better knowledge of physical world. To that purpose, we need more powerful telescopes to see better the characteristics of outer space but we also need more powerful microscopes in order to enquire better into the physical characteristics of the Earth and other planets.

Therefore, the supposed similarity of the neoclassical method with the one typical of natural sciences is misplaced. In natural sciences, the scientific laws do not 'reduce and simplify' the complexity of the world, but add some elements to its explanation. This comes about because in natural sciences the degree of synthesis and abstraction required to the formulation of every scientific 'law' is checked by a continuous interaction between theory and observation.

Conversely, in our view, neoclassical economics' methodology seems more similar to metaphysics than to scientific enquiry. As we know, this theory is based on two basic and grand postulates – the '(instrumental) rationality' of economic behaviour and the optimising properties of the market – which have the character of a wishful thinking and are not open to any real 'confirmation'.

In fact, even when empirical analysis is found to be useful for studying the performance of these 'laws' in real situations, the results obtained can never change or refine such postulates, just because they have the nature of metaphysical entities. For instance, if an empirical analysis indicates that individuals behave rationally according to some proxy (for instance, if consumers choose the item at its lowest price) the theory is 'confirmed'. If, however, empirical observations point out the presence of 'irrational behaviour' (when, for instance, consumers systematically do not choose the lowest price), this does not impinge on the prime postulates, but tends to be 'rationalised away' by treating these results as exceptions or due perhaps to some unwelcome 'exogenous' factor.

It is plain that this methodology can open the door to a process of simplification and misinterpretation of economic and social reality. In this regard, it is interesting to note that the positivist methodology relying only on 'quantitative phenomena' opens the door to the supremacy of the basic tenets of neoclassical theory.

In fact, as quantitative enquiry alone cannot reach the "soul and the heart" of the phenomena (see also the next paragraph), the implicit philosophical and psychological foundations underpinning the 'basic principles of a theory' can never be really questioned.

In some way, a similar story took place in psychology, where the progressive affirmation of a narrow conception of behaviourism was not effectively questioned by more humanistic fields of psychology.

The Various Dimensions of Empirical Analysis

On these issues, institutionalists' reaction was not very effective. We can see this, for instance, in Mitchell's answer (1928) to the criticisms levelled at his previous position on the importance of quantitative analysis. In such rejoinder, true, he clarified the possible limitations of qualitative analysis, which stem from the circumstance that economic and social phenomena can never be investigated with the precision of a laboratory experiment.

However (see also the next section) his view that the qualitative phenomena can properly be investigated only through identifying some measurable proxy weakens and confuses his (correct) stress on the importance of empirical analysis.

Therefore, a fairly obvious rejoinder would have been that every theory should find confirmation in the empirical evidence writ large. This would include the whole set of observable phenomena, both measurable and not measurable. We can identify three levels of analysis:

- (A)** Many socio-economic phenomena have, along with some measurable dimensions, a set of qualitative aspects that require a qualitative interpretation (which involves a process of social valuation also related to the interpretation of quantitative data). For instance, in the analysis of a particular market, we certainly need quantitative data on supply, demand and prices. But, in order to get a comprehensive understanding of the phenomenon, we also need a wide range of qualitative information on the characteristics of the institutional, social, cultural and psychological features that combine to define such market structure.

- (B)** There are various phenomena for which there are no measurable dimensions but can be nonetheless scientifically addressed. For instance, in a music school how can we 'assess' the proficiency of students without resorting to measurable proxies? Or, how can we 'demonstrate' that, for instance, we love our friends, or that John is more friendly than Patrick? In this regard we think that, although in these matters there is no direct demonstration as in the case of, say, identifying the fastest runners, a more 'qualitative-oriented' demonstration is possible. For instance, arts criticism and schools music have elaborated many criteria for assessing artistic creations and musical proficiency, and humanistic psychology has devised many criteria for understanding the qualitative aspects of feelings (which, as noted before, have nothing to do with the *a priori* identification of 'laws' typical of neoclassical economics). Needless to say, these assessments will always be more tentative and open to question than, say, the speed of runners. However, this does not imply that these findings are 'less scientific', but only that the issues addressed are more complex.

- (C)** As a way of synthesis, how can we assess whether (and in what degree) a collective and evolutionary context (with its culture, institutions, norms, organisations and policy action) is conducive to economic and social progress? Of course, we can identify quantitative proxies for many phenomena, but this does not eliminate the necessity — in order to avoid the danger of simplification and reductionism — of evaluating the qualitative and specific aspects of the phenomena considered. Such appraisals would involve a process of social valuation, which is a distinctive notion¹⁷ of OIE. Such concepts lie at the heart of policy action and are also likely to influence the interpretation of quantitative data.

¹⁷ For a good analysis of such concepts see, for instance, Tool (1986).

In concluding this section, and also as a way to introduce the next, we can so synthesise the relevance for OIE of clearly adopting a more comprehensive conception of empirical analysis:

- (I) A distinctive trait of the OIE is a holistic conception of the persons in their individual and collective expressions.
- (II) This requires an interdisciplinary approach in order to better analyse the multifarious ties between persons and their economic, social and cultural contexts.
- (III) For this reason, the OIE approach strongly demands a conception of 'scientific evidence' that – by going beyond the narrow positivistic claim that only 'measurable phenomena' can have 'scientific validation' – would fully consider the whole set of qualitative and non-measurable phenomena.
- (IV) There were, between early institutionalists, various (and evolving) opinions on the 'pragmatist' and 'positivist' conception of economics: for instance, the differences – along with significant common aspects – between J.R. Commons's and W.H. Hamilton's reliance on case-studies and legal analysis, on the one side, and W. Mitchell's emphasis on statistical analysis are well known. However, the methodological implications of these approaches were most often implicit, because they also tended to be intermingled with other issues. Hence, Mitchell's Presidential Address did not manage to steer institutionalists towards a thorough debate on these aspects.

5. The Need of an Interdisciplinary Approach

As we have seen, one distinctive aspect of institutional economics was its interdisciplinary orientation. This applies in particular to psychology, where institutionalists explicitly set out on their research agenda a close collaboration. This can be seen, for instance, in the following passage by Mitchell,

'As soon as an economist has assimilated this idea that he is dealing with one aspect of human behaviour, he faces his share in that problem so conspicuous in current psychology, nature and nurture, the propensities with which men are born and their modifications in experience. I do not imply that the economist must read all the literature upon instincts and repressions which the psychologists publish. Doubtless acquaintance with that literature is helpful; it suggests a wide variety of hypotheses, and it makes one critical of the naïve theories of human mind which each mind proffers in profusion' (Mitchell quoted in Tugwell, 1924, p. 23).

However, despite this far-sighted agenda, institutionalism did not fully realise its promise. True, there were, in the institutionalism heyday, several contributions that employed (and even created) psychological concepts for explaining economic behaviour. These contributions, however, despite their innovativeness, rarely went beyond the form of acute intuitions. They remained – with the partial exceptions of Veblen's theory of instincts and Commons's 'negotiation psychology' – in a rather undefined and 'liquid' state which never hardened into a more systematic theory able to constitute an alternative to neoclassical economics. There are several reasons for this outcome, some 'endogenous' and other 'exogenous'. Among the endogenous factors we can mention:

- (I) In the first decades of the 20th century, both neoclassical and institutional economics were still 'young disciplines' and, for this reason, were characterised by an intense debate, within and between their fields, over their core concepts and the implications for policy action. These discussions, although more so in the newly-born institutional economics, were relevant also for neoclassical economics. One consequence of this was that the boundaries¹⁸ between neoclassical and institutional economics were more blurred than today. Hence, on the one hand, **(a)** many neoclassical economists seemed more willing to acknowledge that their basic hypotheses – the rationality of economic agents and the perfection of markets – were most often quite unrealistic and that public intervention was needed in many cases to reduce market imperfections. And, on the other hand, **(b)** many institutional economists accepted in various degrees the principles of neoclassical economics.
- (II) Manifold influences intervened between institutionalists and neoclassicists, which created a lively intellectual atmosphere. Such process was strengthened by the parallel developments in the psychology and philosophy of Pragmatism, and by various developments in sociology and social psychology. We remember, among others, the contributions of John Dewey, William James, George Herbert Mead, Charles Sanders Peirce in the sphere of Pragmatism and of Ernest W. Burgess, Charles Horton Cooley, Everett Hughes, William F. Ogburn, Carleton H. Parker, William Thomas in the realm of sociology and social psychology. As already noted, these contributions were infused with a feeling of optimism about the potentialities of public policies to foster economic and social progress, and a positive intellectual bridge was laid out with many institutional economists. In our view, this process, while providing interesting insights, also had a weakness. This can be located in a partial lack of awareness that, in order to go beyond the simplistic hypotheses of neoclassical economics – in particular, rational economic behaviour and perfect markets¹⁹, with the consequent optimising equilibrium – and to explain the positive and negative aspects of the real world, a brand new theory of the human mind was highly needed.
- (III) Another reason that could have contributed to this difficulty was the rather unclear state of the relations between theoretical and empirical analysis. As noted before, this aspect characterised not only institutionalism but also social and psychological sciences.

These aspects can also be latched to the following 'exogenous factors':

¹⁸ Refer for more detail to the interesting reconstruction of Yonay (1998).

¹⁹ As already noted, many neoclassical economists were aware that these hypotheses were too simple to capture the complexity of the real economic behavior. However, they tended to regard such hypotheses as a useful approximation and to consider unnecessary any interdisciplinary collaboration. For instance, in the case of rational behavior, they tend to think that, true, there are complex reasons underlying economic behaviour but it is not the business of economists to enquire into them. For the purpose of economics, it is sufficient to hold that, at least in ordinary situations, people behave in a sufficient rational way – or, at least, not in a persistent irrational way. However, in our view the unconvincing aspects of neoclassical hypotheses remain. In fact, as highlighted by many contributions of social and psychological sciences, while it is untrue that people behave in a persistent irrational way, it is likewise unrealistic to suppose a tendency towards an abstract and rational economic behavior. This comes about because such behaviour is heavily embedded in the evolution of social and cultural spheres, with all the related sets of values, motivations, conflicts and contradictions at individual and collective level. Hence, only a careful study of the given situation can shed light on the real social and psychological forces underlying economic action.

- (IV) Psychology was characterised, in the early decades of the 20th century, by the development of various and often conflicting theories, which made it difficult for social scientists to get a clear orientation between them. Also it became difficult for social scientists to employ a number of relevant psychological concepts (for instance, cognitive limits and biases, the role of emotions, the interrelations between cognitive and emotional sphere, which only later on reached a more fully-fledged development) to the study of economic and social phenomena.
- (V) At the same time, and in parallel with the relatively slow progress of other fields of psychology, there was a quick affirmation of behaviouristic psychology – in the positivistic meaning referred to above – according to which the only relevant behaviour is the one that can be observed and ‘measured’ through a number of proxies.

The Relevance of Qualitative Analysis

For all these reasons, the institutionalists’ theory of economic behaviour was not strong enough to constitute a well-framed alternative to the narrow conception of *homo oeconomicus*. Their contributions were significant but piecemeal, and sometimes tended to shift towards a narrow conception of behaviourism. This can be seen in Mitchell’s Presidential Address mentioned before. The following passage constitutes a good synthesis of Mitchell’s position,

‘.... “Institutions” is merely a convenient term for the more important among the widely prevalent, highly standardized social habits. And so it seems that the behavioristic viewpoint will make economic theory more and more a study of economic institutions... The extension and improvement of statistical compilations is therefore a factor of the first consequence for the progress of economic theory. Gradually economics will become a quantitative science. It will be less concerned with puzzles about economic motives and more concerned about the objective validity of the account it gives of economic processes’ (*ibidem*, p. 25, 27).

The rationale underlying Mitchell’s position was, at that time, quite innovative: in fact, it rested on the purpose of getting more precise data in order to go beyond a mere theoretical speculation associated with facts. This was particularly the case for the analysis of business cycles, where he clearly recognised the complexity, the importance of context and the specificity and common aspects of the various cycles.

As also noted before, we believe that Mitchell’s position on the importance of data is quite appropriate, with its limitation resting on considering as reliable data only those based on statistical aggregates.

In this context, the stress on the quantitative side of phenomena gradually became a common sentiment in this period, and was emphatically expressed by the following passages from F.C. Mills,

‘The modern economist enumerates, measures, weighs... “When you cannot measure what are you speaking about, when you cannot express it in numbers”, said Lord Kelvin, “your knowledge is of a meager and unsatisfactory kind; it may be the beginning of knowledge, but you have scarcely in your thoughts advanced to the stage of a *science*, whatever the

matter may be"... In summary: Our useful knowledge of events in the world about us is essentially statistical in nature; that is, it is not concerned fundamentally with unique, individual events, but with aggregates of events which may be described in terms of averages, of typical characteristics. In generalizing about such aggregates we are of necessity precluded from speaking in terms of invariant laws' (Mills, 1924, p. 37, p. 46).

Now, of course, we acknowledge the pertinence of statistical analysis for gathering a better knowledge of economic and social phenomena. The aspect upon which we cannot agree is that the relevant data can be obtained *only* from statistical enquiry. As observed before, economic and social reality is composed of many qualitative and non-measurable phenomena which could be addressed in a scientific way.

For instance, in the above example of child behaviour at school, it is certainly useful to collect statistics on attendance and performance, as well as on the characteristics of the school system and of the family and social structure of the children. But these data are neither the only relevant ones nor the only obtainable ones.

One solution to this problem, which lies at the heart of the positivist attitude, is to broaden and refine statistical procedure by including more variables, by rendering the proxies more precise, and by devising more effective indicators.

This pathway can be useful, of course, but it is also true that statistical analysis cannot capture all the complexity of the phenomena under examination. The reason for this is simple enough, that statistical data – for instance, on children behaviour, consumption and investment – are obtained by comparing some measurable dimension of phenomena which are themselves composed of many other aspects. Hence, these phenomena (and in particular the complexity of persons in their individual and collective expression) are always something more than (and hence cannot be reduced to) the sum of their 'more measurable' parts. For this reason we can never directly measure 'the heart and soul' of the living persons.

For this reason – and in order to avoid the well-known dangers of simplification and reductionism – statistical analysis should always be coupled with case studies and other methods for acquiring more 'direct and qualitative'²⁰ data on the phenomena under investigation.

These two conceptions of scientific analysis carry very different perspectives on the scope of institutional economics, also in its relation with psychological sciences. In the case of positivist attitude, the only aspects deemed scientific are those amenable to quantitative expression whereas, in the case of pragmatist and humanistic perspectives, the analysis tries to consider all the relevant aspects – both 'qualitative' and 'quantitative' – which concur to identify economic and social phenomena at individual and collective level.

As noted before, the failure of institutionalists to single out the various conceptions of empirical analysis have impaired their potential for a more comprehensive investigation of economic and social phenomena. Also for this reason, developments in economics (in particular, neoclassical and neo-Keynesians) in the post-World War II period have become more and more 'quantitative' by relying almost exclusively on econometric analysis. In this way, as already noted, the validity of the basic neoclassical hypotheses of market perfection and rational economic behaviour can never be really questioned.

However, this rather gloomy picture requires a couple of notes. Firstly, despite the limitations mentioned, some interdisciplinary synergy has always occurred in the

²⁰ It is interesting to note that, from a different perspective, N. Georgescu-Roegen (1971) underscored that one central implication of the entropy law for economic analysis is to facilitate the analysis of the qualitative transformations of the system.

institutionalist domain. This applies especially to the philosophy and psychology of pragmatism, with the use of the concepts of habits, social norms, social identity, cognitive faculties, purposive action for the interpretation of economic and social phenomena. Secondly, two important institutional economists, Thorstein Veblen (1914) and John Rogers Commons (1934), developed an economic theory which makes explicit use of psychological concepts.

However, these insights remained largely unfledged for many years. In fact, the various contributions provided by institutionalists mostly remained at the stage of intuition and did not reach the state of a more organic theory. One reason for this was the notable fragmentation – despite many relevant common aspects – of the institutional field. In this sense, not only there was little synergy between the main fields of institutionalism; but also within each field, each contribution seemed to go its own way, as an intellectual island without much synergy with the others.

6. Conclusions: the Institutionalism's Eclipse and the New Wave of Today

As a consequence of the limitations outlined above and of more 'exogenous factors' as well, institutional economics became progressively marginalised in the profession and in the society at large in the post-WWII period.

In fact, from the more orthodox perspective, it was all too easy to dismiss such school as 'a narrative without a theory'. Perhaps even worse, institutional economics largely failed to make waves even in the field²¹ of heterodox oriented theories. We have seen before its problematic relation with Keynesian theories.

In addition, the interchange with Marxism and other theories of social justice was not a smooth one. Here, however, the situation seems slightly better. In fact, contrary to Keynesian economics, institutionalism has established a more systematic collaboration with Marxism, in particular regarding the concept of power and the character and evolution of capitalistic institutions. However, despite this interchange, in Marxism and other more 'radical fields' of social sciences, institutionalism has most often not gained a great appeal – it was not even much known within the progressive field – as it was considered either a kind of utopian radicalism à la Veblen or a kind of reformism à la Commons, 'too gradualist' to fit the impatience of the revolutionary aspirations.

In this very difficult situation, institutionalists were nonetheless able to survive and produce notable contributions on a wide range of theoretical and applied issues. And, despite the insulation and fragmentation which characterised institutionalism, and the whole realm of social and psychological sciences, some useful reciprocal influence did occur in the field of economics. Indeed, it would be a mistake to infer that institutionalists' contributions – owing to their relatively marginalised position – went unnoticed among the economics profession at large. Concepts²² like the importance of the institutions in economic and social life, the role of habits, the structure of power, the imperfection of markets, the distinction between the instrumental and ceremonial aspects of institutions, the role of social valuing, the relevance of the formal and informal rules, the characteristics of cultures, and the overall evolutionary

²¹ Needless to say, this is a broad assessment that requires a much more careful analysis of specific factors: for instance, what happened in this respect in Europe and USA; and what had been the evolution of the various fields of OIE, also in relation to the parallel evolution of other strands of heterodox economics.

²² For more details on these developments refer, among others, to Gruchy (1972), Hodgson, Samuels and Tool (1994), Tool (1988).

perspective pervading all these aspects, have exerted a discreet but enduring influence on the way of reasoning of many economists.

This situation characterised the post-WWII period until, approximately, the late 1980s. After that period, there has been a kind of new spring of institutionalism and other heterodox perspectives, which is notable and still on the ascendance. For example, can see the probable influence of, among many others, the following factors: **(i)** the crisis following the oil shocks of the 1970s made evident the insufficiency of the simplest versions of Keynesian policies; **(ii)** the growing awareness of the inadequacy of the more extreme versions of both central planning and neo-liberalism to address the imbalances of economic and social phenomena: in particular, highly uneven distribution of income and wealth, unemployment and deterioration of working conditions, environmental decay, political and social conflicts. These imbalances culminated in the recent economic crisis, which has triggered a kind of a general reshuffle of all the received economic and social theories.

This has happened also within mainstream domain. True, even in our time, neoclassically oriented theories are still the 'mainstream position' but their leading role is much more blurred and problematic than before. With regard to heterodox economics, there has been a flourish of new initiatives. New associations have been created – for instance, the Association for Heterodox Economics (AHE), the European Association for Evolutionary Political Economy (EAEPE) and the World Economics Association (WEA) – and the existing ones (in particular, AFIT, AFEE, ICAPE, URPE) have become more active and influential. They organise an annual conference and other initiatives, in particular for students. They also promote, or are involved in, the activities of a number of scientific journals. There is a growing attention to heterodox issues and there is a steady increase in the people involved in these activities.

The *spectrum* of subject-matters covered by heterodox contributions is ample and continually widening. There are also many works which apply these theories to the study of specific economic and social problems, often considered in their cultural and historical perspective. Despite this progress, the situation for heterodox economics remains troublesome. One reason is that this germination of ideas and contributions has not succeeded in securing an adequate foothold as regards financing and academic positions for heterodox economists.

This situation is particularly dangerous for the future of heterodox economics because it does not offer adequate perspectives of tenure and career for the younger generation of economists.

A detailed analysis of this side of the problem²³ is beyond the scope of the work. Perhaps, what is needed for the advancement of heterodox economics is a more systematic attention to policy issues. As a matter of fact, if we present our activities as a forum for pluralism, this looks fine, but risks to be perceived both by the more informed audience and by the lay people as an interesting intellectual venture with, however, no tangible results in terms of better policies. And this in a period where there is a high (explicit and latent) demand for new policy solutions for the major economic and social problems.

In order to attain this purpose, an adequate strengthening of the interdisciplinary potential of institutional economics seems paramount. In particular, a more systematic collaboration between institutional economics and psychological sciences can help locate the multiple levels of collective action, and in particular: **(i)** the complexity of individual motivations and systems of values, where the relational and social dimensions play a paramount role; **(ii)** the complexity of policy action, which involves not only governmental institutions but also every other level of collective action; **(iii)** consequently, the fact that the dynamics of

²³ For more details see Elsner and Lee (2008), Lee (2009), Lee et.al. (2010), Reardon (2009).

institutions and the dynamics of policies represent complementary aspects of collective action, where, in the first (the institutions) the stress is on structure, decision-making process and cultural evolution, while in the second (the policies) the focus is on action and results.

In the analysis of these problems, by clarifying the needs and conflicts arising at individual and social level, institutionalism, also in collaboration with other strands of heterodox economics, can help formulate policies more precisely based on the motivations and experiences of people involved in collective action.

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