

Veblen, Hayek, and Coase and the History of Institutional Economics

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ABSTRACT: RH Coase popularized his program of *Comparative Institutional Analysis*, while the institutional analysis of TB Veblen and FA Hayek fell in to relative obscurity. This paper examines an unnoticed advantage of Veblen/Hayek institutional analysis. Coaseans *compare* the most similar attributes of institutions. Veblen and Hayek *contrasted* institutions according to their most fundamental differences. In particular, Veblen and Hayek each contrasted finance capitalism with technocracy. The Coasean and Veblen/Hayek research programs should be seen as complementary approaches to institutional analysis.

KEY WORDS: Institutional Economics, Finance Capitalism, Technocracy

JEL CODES: B15, B25, B31

CREATED ON: November 28th 2007

LAST REVISED ON: June 12th 2009

SENT FOR REVIEW ON:

UNDER REVIEW AT:

This paper is scheduled for presentation at the HES Conference in Denver Colorado, July 2009, and the STOREP Conference in Florence Italy, June 2009.

Institutional Economics, Old and New

The current history of institutional economics is relatively simple. Thorstein Veblen critiqued the basic assumptions of late nineteenth century marginal utility theory. The popularity of Veblen style 'Old Institutional Economics faded in the mid twentieth century. New Institutional Economics emerged during the late twentieth century, largely due to the influence of Ronald Coase and Oliver Williamson. New Institutional Economics succeeded by applying mainstream methods of economic analysis to institutions. There are known points of similarity between Veblenian and Hayekian economics¹. But modern Hayekians have tended to support the New Institutional research program.

This paper takes a different view of the history of institutional economics. Veblen founded a research program of *Contrasting Institutional Analysis*, whereby economists contrast institutions according to fundamental differences. More specifically, Veblen contrasted technocracy with capitalism. F.A. Hayek also contrasted technocracy with capitalism. Both Veblen and Hayek explained institutions in terms of differing mindsets. Coase took Institutional Economics in a different direction by focusing attention on transaction costs. Emphasis on transaction costs by Coaseans led to a program of *Comparative Institutional Analysis*, whereby economists compare institutions according to similar attributes. The displacement of the Veblen-Hayek program was unnecessary because the Veblen-Hayek and Coasean research programs complement each other.

The first part of this paper examines the contrast that Veblen saw between the machine process run by engineers and the commercial process run by capitalists. The second part explores Hayek's analysis of planning by engineers. Part three examines the displacement of the Veblen-Hayek research by Coasean economics. Coasean economics promotes a

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Panglossian worldview, whereby alternative institutions appear similar to the point where there is little reason to substitute one for another. If done correctly, Veblen-Hayek analysis better serves progressive policy agendas. Institutional progress requires us to look past superficial similarities between alternative institutions, and focuses instead on dissimilarities that make institutional choices clear. The Veblen-Hayek research program thus avoids the status quo bias of Coasean-Panglossian theorizing. The final part considers the prospects for popularizing the Veblen-Hayek research program.

Veblen: Engineers versus Capitalists

Thorstein Veblen is often remembered for his critique of marginal utility theory. Marginal utility theory derives from the unrealistic notion of “man as a lightning calculator of pleasures and pains” (Veblen 1898a p389). Veblen specifically targeted the Austrian school in his critique of marginal utility theory. It is, however the case that Veblenians and Austrians advance similar criticisms of Neoclassical formalism. Veblenians and Hayekians view institutions in evolutionary terms (Boettke 1989). Veblenians and Hayekians are targeted with similar criticisms: excessive preoccupation with methodology, intellectual isolationism, paranoia in dealing with other economists, and a tendency to justify extremism as purism (Samuels 1989). Also, both schools originated as reactions to “the political and social milieu of the counties of their origins” (Caldwell 1989).

The similarities between Veblen and Hayek are particularly interesting. Veblen and Hayek both wrote about the role of engineers in society. Veblen and Hayek both critiqued excessive rationalism in social sciences. Veblen and Hayek also both factored unconscious actions into their theories. Veblen stressed cultural habits. Hayek stressed unintended consequences and rule following behavior. We can better understand the similarities between Veblen and Hayek by reexamining their analyses of engineers.

Veblen (1909 p626) defined institutions as “settled habits of thought common to the generality of men”². Veblen’s ‘Old Institutional’ program aims at understanding underlying structural features of alternative capitalist and technocratic economic systems by examining the functional and cultural separation of financial and industrial institutions (Hodgson 1998 p172-173). In other words, Veblen contrasted the profit driven process of financial capitalism with the workmanship and science driven machine process of technocracy³.

Veblen (1899 p209) viewed captains of industry as members of a parasitic leisure class, whose relation to industry was one “of acquisition, not of production; of exploitation, not of serviceability”. Corporate financiers could improve consumer welfare through increased production, but instead acquire wealth “by a shrewd restriction of output”, causing privation and unemployment (Veblen 1921 p27). Monopoly prices slow production. Financiers perfect the art of financial sabotage through extreme specialization in their dealings. Specialization of captains of industry as financiers puts them out of touch with “the manner of thinking, logic, and relevant facts of technology” (Veblen 1921 p26). Early capitalists were familiar with the machine process, but modern corporate financiers exercise control over industry without competent grasp of the industrial arts. Veblen saw finance as an *acquisitive* process similar to the barbaric practices of leisure classes in earlier civilizations. Financial institutions derive from settled habits of thought among specialized profiteers, at the cost of detachment from “the manner of thinking” of engineers. Pecuniary interests and pecuniary habits of mind promote “enactments and conventions that make for security of property, enforcement of contracts, and facility of pecuniary transactions” to gain profit (ibid).

² Hayek (1944 p14-15, 1974 p91-93) also tied alternative institutions to different mindsets.

³ As Harris (1932 p738) put it, Veblen focused on conflict between two opposing principles: vendibility in terms of private profit versus material serviceability that promotes public welfare.

The differing mindsets of engineers and financiers reveal much about the prospects for progressive institutional reform. Veblen rejected Panglossian worldviews that make ideal outcomes inevitable⁴. Engineers could run industry better than financiers, but “there is no present promise” for engineers to replace capitalists as directors of industry (Veblen 1921 p84). The ‘instinct to workmanship’ drives Engineers to use modern technology in machine processes, but at the behest of their profiteering employers. Financiers cannot run industry without engineers, but engineers could run industry without the interference of financiers. Yet, engineers are naturally at a disadvantage relative to financiers. Engineers are by habit a “docile lot” placidly content with their incomes. As part of an acquisitive leisure class, capitalist financiers are anything but docile. Veblen compared financiers with feudal warlords, priests, and tribal warriors, who acquire rather than produce wealth. The financial institutions of the modern leisure class are “derivatives of ancient predatory culture” (Veblen 1899 p209). Engineers might be too docile to seize control of industry, but the parasitic nature of capitalists made their control of industry tenuous.

Veblen’s rejection of representative agents for all institutional contexts is vital to his analysis. Rather than assuming a representative agent for both systems, we can examine two different and opposed sets of institutions by assuming two different classes of individuals composed of distinct and opposed ideal types. Comparative theorizing points to Panglossian conclusions in part because of its use of uniform representative agents in their models of “alternative” institutions. How can institutions differ according to opposed settled habits of thought if we assume that we all simply optimize according to the same standard utility function? Virginia economists often rely on *empirical* evidence to arrive at policy conclusions, as their theoretical analysis is generally inconclusive.

⁴ Hayek (1944 p261-261) also denied that any particular outcomes are inevitable or even wise.

The recognition that habits of thought differ extends institutional analysis to social conflict. Veblen insisted that the engineering mindset and the machine process break down the institutional heritage of business enterprise, and other allegedly archaic acquisitive practices (Veblen 1904). The instinct to workmanship of engineers rejects antipathy to useful effort due to the irksome nature of labor (Veblen 1898 p190). Labor is irksome because of its indignity, as opposed to the prestige of glory-seeking through acquisition (ibid p 201). Business enterprise depends upon the machine process for its profits, but it also interferes with its operation. The acquisitive mindset of both modern finance and ancient predatory practices of warfare and imperialism produce institutions that conflict with institutions that evolve out of the instinct of workmanship.

It is Veblen's great insight that we must look at the deeper motivations and thoughts of different sets of people in order to discern the relative merits and dangers of alternative institutions and systems. Alternative systems also entail different sorting mechanisms that direct different people to positions of authority and subservience. The emphasis on rational choice in Postwar Neoclassical Economics obviously ignores the issues that Veblen focused upon. Veblen's program of contrasting institutional analysis fell out of favor with most mid-twentieth century economists, but not with Friedrich Hayek.

Hayek: Capitalists versus Engineers

Hayek and Veblen both contrasted institutions, but they arrived at dissimilar policy conclusions. Why? Hayek, and Austrians in general, reverse the roles that capitalists and engineers play in society. Austrians take a positive view of competition in financial markets. Capitalist financiers may not understand the technical details of modern production, but they serve the purpose of applying technology to areas of increasing consumer demand, and

withdrawal of capital from areas of declining consumer demand⁵. Financial markets function as the “headquarters of the capitalist system that settle plans for further development” in different divisions of the economy (Schumpeter 1912 p126). Austrians further assert that entrepreneurship can never be reduced to a routine (as Veblen thought), because trends in consumer demand change direction in ways that cannot be reduced to a set formula. Hence Austrians see financiers as planners of rational production, rather than as saboteurs.

Veblen and Hayek both saw the value of technology in modern production. Why then did Hayek see engineers as a threat to progress? Hayek saw different roles for engineers and capitalists in developing industry. Engineers plan projects using scientific facts that can be centralized in a few minds (Hayek 1952 p168). Capital planning requires knowledge of future consumer demands. The demand for state planning of investment gets its main impetus from “the resentment of the frustrated specialists”, many of whom are engineers (Hayek 1944 p62). Public projects get implemented often because of “confusion between technical excellence from a narrow engineering point of view and desirability from the point of view of society as a whole” (ibid p57). In socialism “we should expect to find over-development of some industries at a cost not justified by the importance of their increased output, *and the unchecked ambition of the engineer to apply the latest developments without considering whether they were economically suited in the situation* (Hayek 1935 p204 emphasis added). The main economic issue here is opportunity cost. Changes in consumer demand require expansion and contraction of

⁵ According to Schumpeter 1(912 p75) Entrepreneurs drive economic development by introducing new goods and methods, opening new markets, and by acquiring new sources of supply. Entrepreneurs direct production into those channels which satisfy the most urgent wants of the consumers by withdrawing capital from some lines of production to apply it elsewhere (Mises 1922 p121). Entrepreneurs reallocate capital goods as they “buy and sell stocks and shares, make loans and recover them, and speculate in all kinds of commodities” (ibid). Entrepreneurs promote efficiency because the market test of profit and loss eliminates entrepreneurs who forecast changes in consumer demand incorrectly (Mises 1949 p701). The stock market acts as a central forward market that reconciles plans for future production (Lachmann 1977 p124). Speculators in the stock exchanges express expectations about different industrial plans and thereby evaluate different capital combinations.

lines of production, based on local economic conditions. Since economic knowledge is subjective and dispersed, we need money prices to reveal the nature of relative preferences, based on consumer willingness to pay.

Engineers must take heed of prices for the resources needed to complete a project. However, engineering principles can neither explain why prices may prohibit a particular project that makes sense in engineering terms, nor explain why price changes may end a technically superior engineering project after it has begun. A technically perfect project, in the engineering sense, would always be desirable in a world with abundant capital and an interest rate of zero (Hayek 1952 p172). Scarcity demands that interest rates and other prices guide an engineering project if it is to fit in with the pattern of investment throughout the rest of society. Hayek therefore insisted that ‘the ambition of engineers’ had to be checked by the price system.

Veblen held a less optimistic appraisal of the price system than did Hayek. But the main point here is that Hayek agreed with Veblen that the outlook of engineers differs radically from merchants and tradesmen (see Hayek 1952 p174). Hayek thought that the work of merchants or capitalists is *more* social than the work of engineers. Engineers concern themselves with universal scientific truths, but capitalists focus on particular market conditions. Enthusiastic specialists can become “single minded idealists”, who assume a mission to improve humanities lot (Hayek 1944 p62). The fact that no one or few minds can hold more than a fraction of knowledge on local economic conditions sets limits on the extent to which conscious planning of production by authorities can improve upon the unconscious coordination of capitalist plans by market prices (Hayek 1952 p178).

Hayek saw differences between engineering and capitalist mindsets as deriving partially from difficulties that both groups have in perceiving the merits of the market system.

Engineers needed to have their ambitions checked because their inability to perceive the merits of the market system leads them toward fanaticism. The subtlety of the invisible hand of markets leads engineers to *underestimate* the importance of entrepreneurship, and consequently they will tend to *overestimate* their own importance. Moreover, engineers can come to view financial considerations as obstacles to achieving true efficiency. As before the argument at hand depends upon the subtleties of the market also being realities.

Hayek and Veblen also held different views regarding the relative assertiveness of capitalists. Hayek and other Austrians criticize entrepreneurs for their timidity in defending capitalist institutions. Mises (1922[1936]) claims that businessmen are timid and muddled in defense of private enterprise because they do not understand the positive role that they themselves play in society. Hayek (1960 [1992] p130) derides mercantilist and Keynesian ideas as ‘the short-sighted philosophy of the businessman, which undermines free markets. Schumpeter (1942[1950]) thought that capitalism would end because of the failure of capitalists to offer an intellectual defense against the ‘carping criticism’ of intellectuals. Hayek (Hayek 1949[1967]) extended Schumpeter’s analysis of intellectuals. Intellectuals transmit ideas from specialists (i.e. economists or engineers) to the general population. Since intellectuals are generalists, they possess only a superficial understanding of the ideas they disseminate. Intellectuals judge the merits of new ideas according to how they fit into the prevailing climate of opinion. Intellectuals have interpreted the successful application of scientific principles by engineers as proof that society should be planned along similar scientific lines (Hayek 1949[1967] p187). The lack of a deeper understanding of economics on the part of intellectuals prevents them from seeing that the scientific principles of engineers are not applicable to economic planning.

Ideally, intellectuals bridge gaps between different groups of specialists, whose mindsets differ. Hayek thought that as a practical matter intellectuals favor the technocratic point of view. While Old Institutionalists might object to the particulars of Hayek's analysis of intellectuals, this is an issue that should interest them greatly. If the settled habits of thought of different groups are the basis for institutions, then the processes by which the ideas of different groups are disseminated and altered explain institutional change.

Capitalists are often as misinformed about capitalism as are intellectuals. Capitalists are profit minded, but their pursuit of profit leads them to focus on the conditions they face in a narrow sector of the economy. The price system works to inform entrepreneurs of global economic conditions. The social functions of the price system are not necessarily obvious. Capitalists have *direct* knowledge of local economic conditions, and will often underestimate the significance of their own actions in the global economic system. Consequently, capitalists often fail to appreciate the social significance of their actions.

While Hayek saw the technocratic movement to consciously plan society as susceptible to the influence of 'fanatics' and 'single minded idealists', Veblen saw potential leaders of technocracy as docile to the point where their chances for success were questionable. Veblen saw capitalists as bold, but Hayek saw them as feeble (in political matters) due to economic illiteracy. Hayek reversed both the roles and the mindsets of engineers and capitalists. Veblen and Hayek arrived at contradictory conclusions through opposite assumptions and arguments regarding the mindsets and economic functions of capitalists and engineers. But they also reach their conclusions both by contrasting alternative institutions.

While one can disagree with the specifics of Hayek's arguments, the general point about Hayek's approach to institutional analysis is clear. Hayek and his fellow Austrians contrasted finance capitalism with other systems. Industry cannot be planned rationally by politicians,

bureaucrats, workers, or engineers because rational capital investment requires market prices. Planning of production without prices, especially in futures and other financial markets, would fail to take the scarcity values of factors of production into proper account. That is the essential difference between the price system and planned systems.

The Rise of New Institutional Economics

The institution-free nature of Arrow-Debreu type general equilibrium theory left a serious deficiency in postwar mainstream economics. Coase (1937) laid the seeds for a movement that would appear to close this gap.

Coase did not shut the door to Contrasting Institutional Analysis. Alchian and Demsetz (1972) dismissed Coase's treatment of the firm as a center of planning. Subsequent development of New Institutional Economics focused increasingly on applying formal Neoclassical models to institutions. The universal application of Neoclassical models led naturally to comparison of supposedly alternative institutions. Furthermore, the use of *Homo-Economicus* as a representative agent prevented consideration of alternative mindsets as the driving force behind differences in alternative institutional systems.

New Institutional Economics has limited academic value as a means of comparing alternative institutions. But policy issues are better understood through the contrast of alternative institutions. Veblen and Hayek identified the source of differences in institutions: differences in mindsets or habits of thought. The rise of New Institutional Economics set these vital issues aside.

Past Mistakes, Future Prospects

The Coasean and Veblen-Hayek research programs each contribute significantly to our understanding of institutions. The Veblen-Hayek program of contrasting institutions

requires that we examine the fundamental motivations behind human behavior carefully. The economic approach of welfare maximization represented by constrained optimization problems does not allow for a full analysis of Veblen-Hayek type issues. The Veblen-Hayek program takes us beyond conventional economics. Veblen took an interdisciplinary approach to institutional analysis, as did Hayek. Veblen stressed habits, norms, and psychology (Hodgson 2007). Hayek also considered habits, or rule following behavior, and the limits of rationality. Much of our activity is directed by rules that we do not understand explicitly: we can converse using the rules of grammar without explicit knowledge of these rules (Hayek 1967 p 45). We do not comprehend the specific reasons for why a particular practice works, but we can observe that it works. In a particularly telling passage Hayek (1973 p11) notes “man is as much a rule-following animal as a purpose-seeking animal”. Veblen sees purposeful action as guided to some degree by intelligence (Vandenberg 2002 p223). Once again, Veblen and Hayek both sought contrast, but based their analysis on different assumptions regarding particular human mindsets and abilities.

The similarities between Hayek and Veblen on human mindsets and abilities (as opposed to human nature) relate to the problems that Veblen sees with the fact that highly specialized financiers are detached from the machine process. Capitalist financiers need only observe the possible uses for technology to align capital with expected shifts in consumer demand. Also, we need not all understand how an institution improves our welfare to actually benefit from that institution. Social orders can emerge as result of human action, but not of human design (Hayek 1967 p97). The market system might have been regarded as the finest invention of the human mind, had it not emerged spontaneously (Hayek 1945). Rather than designing societal rules deliberately, we have adapted and revised the rules that constitute institutions gradually through experiential learning (Hayek 1973 p45).

While Veblenians and Hayekians can disagree as to whether or not markets emerge spontaneously or are efficient, such a discussion is facilitated by similarities in the general approaches of Veblen and Hayek. If we can agree on the *general approach* of contrasting institutions according to differences, and that such analysis must take full account of habits or unconscious behavior, cognitive limits, and psychological factors, then we can proceed with a serious discussion of the *particular features* of the aforementioned factors.

Coaseans and Hayekians are often seen as intellectual allies. Coase and Hayek were both skeptical about the increased state regulation of commerce. Modern Coaseans tend to reject Hayek's evolutionary approach to economic analysis in favor of equilibrium theorizing (Kerber 2006 p457)⁶. The differences between Hayekians and Coaseans run much deeper. Hayek contrasted institutions according to fundamental differences, but Coaseans explicitly aim at comparing institutions⁷. *New Institutional Economics* and *Public Choice* apply the same models to private and public institutions. The Coasean-Comparative approach has led to some legitimate insights, often through the use of game theory. Game theory has displaced general equilibrium analysis at the cutting edge of economic analysis (Hodgson 2007 p328). Game theoretic analysis is superior to Walrasian economics because it focuses attention on institutions, conventions, and rules. But game theoretic models tend to underemphasize the fundamental issue of how institutions differ according to variations in "settled habits of thought common to the generality of men". Stanfield (2006 p255) argues that the Veblenian program of evolutionary economics is superior to Neoclassical economics because it "seems to be constituted by its emphasis on adaptive or dynamic efficiency, the motivational

⁶ It should be noted that Alchian (1950) and Demsetz (1967, 1973) thought in both evolutionary and Coasean terms.

⁷ See Demsetz (1969) and Coase (1960).

complexity and cognitive limitations of its agents, and the necessary conceptual breadth with regards to governance”. Stanfield is correct, but his reasoning needs to be clarified further.

We can understand the full significance of institutions only by contrasting opposed habits of thought. Walrasian economics fails to recognize that all exchange is embedded in institutional contexts based on habits of thought. The Coasean program does too little to remedy this defect. Coasean type analysis aims at explaining underlying institutions, but in terms of standard models of a world populated by ‘representative agents’ with uniform. The Coasean practice of applying the same models to all systems of institutions tends to conflate alternative institutions by eliminating the main reason that Veblen and Hayek saw for institutional variety- differing mindsets. But social and political institutions vary between cultures and classes because of *dissimilar* habits of thoughts vary between such groups. Our conscious actions are therefore embedded in *different* habits and norms. This is not simply a matter of variations in preferences. Differences in mindsets imply differences of opinion in what constitute the best means of attaining any particular set of ends. The Veblen-Hayek program yields additional and more conclusive insights because it examines the most *dissimilar* characteristics of alternative social and political institutions as means towards the general end of improved human welfare. The Coasean program thus downplays the importance of its own subject matter. Full appreciation of institutional context requires recognition that such contexts are determined by variations in the mindsets and perceptions of individuals, and it was Hayek and Veblen who focused on these variations.

The comparative institutions approach has led some scholars to conflate alternative institutions to a point where it is hard to see why we should favor one over the other. Stigler (1992), Becker (1958), Breton (1989) and Wittman (1995) use the comparative approach to arrive at Panglossian conclusions regarding institutions. Chicago theorists conflate the

private and public sectors to the extent where inefficiency becomes inconceivable. Becker (1958 p106-107) insists that democracy and markets are the same, provided that we assume a similar level of competition, and also that “all voters have the same preferences”. Becker arrives at the stunning conclusion that markets and democracy yield the same results, provided that you conceive of these institutions as functioning in exactly the same way.

Stigler and Wittman follow their arguments to the conclusion that what is must be efficient, because rational people will always choose the best institutions. Rational people will not tolerate sub-optimal institutions in either the public or private sector. Institutions lose their significance once we assume uniformity of mindsets, as Chicagoans effectively do when they represent all agents with *identical* utility functions. Becker and Stigler (1977) allow for differences in developed human capital, but not underlying preferences. Since Becker and Stigler ignore psychology and interpretation, habits of thought are represented by utility functions, if at all. Differing habits of thought do not exist in Chicago Public Choice.

There is a profound difference between the Chicago and Veblen-Hayek research programs, one that goes deeper into the usual equilibrium versus process distinction. Kirzner (1960) criticizes the notion of economizing advanced by Robbins (1932). Robbins type economizing focuses on the selection of known means and given ends. The Austrian notion of human action examines the selection of perceived means and momentarily desired ends. Once we allow for change in both perceptions regarding means and the ends that for which we aim, it becomes possible to examine the process of learning as we compete through time. Neoclassical or Chicago type models do not allow for human action in real time, as there can be no real change where means and ends are clearly defined as mathematical functions (O’Driscoll and Rizzo 1985). Furthermore, the Chicago approach strictly limits our analysis of institutions to transaction costs because the objectivity of all cost and utility functions in

Chicago models assume uniformity of thought that does not exist in the real world. That is we can only understand real institutions in real time by viewing competition as “a procedure for forming opinions” (Hayek 1948). There is a strong connection between the ‘real time’ issue and the ‘differing mindset’ issue. Equilibrium requires mutual plan consistency (Hayek 1937). Plan consistency comes about from uniformity of opinion or by pure chance. Chicago economics is built using uniform representative agents, who both have the same general types of utility functions and the same perceptions between economic means and utilitarian ends. The use of representative agents by Chicago economists therefore trivializes time (in terms of learning and error correction), while also establishing conditions where institutions tend toward a high degree of similarity. That is, the tendency of Chicago economists to both ignore processes and conflate ‘alternative’ institutions, derives from the same source: their use of homo-economicus as a representative agent.

The particular views of Veblen and Hayek represent two distinct and opposed views of modern industrial capitalism. Yet, they arrived at their views through a common research program. Veblen and Hayek both examined modern industrial capitalism by contrasting alternative institutions. Veblen and Hayek largely agreed as to the nature of engineering, but disagreed regarding the commercial institutions of modern capitalism. While Veblen saw entrepreneurship and commerce as parasitic, Hayek and his allies saw it as productive. Veblen and Hayek arrived at different conclusions due to their assumptions regarding the fundamental characteristics of commerce and entrepreneurship. It is also worth noting that Hayek developed a notion of emergent institutions that depends not only upon differing mindsets, but upon knowledge that is inarticulate and implicit to behavior. We comprehend rules of behavior by first observing discernable patterns in our actions, but this discernment is itself based on new patterns of thought, the rules of which must be observed and then

explained (Hayek 1967 p60-61). Hence there is always a level at which the rules that govern our thoughts and actions are unexplained or instinctive. Neoclassical models can therefore never fully explain real world institutions.

Vandenberg (2002) notes that Douglass North combines elements of New and Old Institutional Economics. North provides a more realistic option to institution-free Walrasian economics, one where ideology and sociological factors matter. North's emphasis on ideology hits the Veblen-Hayek nail on the head: habits of thought matter. North has pointed to the contrast between different types of systems. North (1991) contrasts parochial 'systems' of local trade, self-sufficiency, and dense social networks with a cosmopolitan system of long distance trade involving complicated agency and enforcement problems. North places heavy emphasis on Coasean transaction cost and agency issues in his analysis. But North has actually shifted New Institutional Economics towards Veblen and Hayek with by incorporating ideology into analysis that contrasts alternative systems of institutions.

The Future of Institutional Economics

The Veblen-Hayek research program has undergone an extended period of neglect. There are strong reasons to end this neglect. Coasean Analysis has been done to the point where returns on further research must have fallen considerably, so the Veblen-Hayek program might offer better opportunities. The approach of contrasting alternative systems according to their fundamental difference ought to be combined with the comparative-Coasean approach because a full explanation of institutions requires that we consider *all* of their significant attributes. This being the case, neglect of the Veblen-Hayek research program by mainstream economists is unwarranted, and should cease.

Of course, some mainstream economists have dismissive attitudes towards Hayekian and Veblenian arguments regarding policy. Veblenians are sometimes regarded as overly hostile

towards free enterprise; Hayekians are regarded as overzealous in our defense of free enterprise. Such objections have no bearing on this paper. If specific Veblenian or Hayekian arguments are invalid, these arguments ought to be examined rather than simply ignored. Part of the reason for the dismissive attitude towards Veblen-Hayek type analysis might be that the full merit of the Veblen-Hayek method has not been made clear. The general idea that we must both compare *and* contrast institutions has merit in its validity and simplicity. How could anyone fail to agree with something so straightforward?

Mainstream economists accept Coasean analysis of institutions. Mainstream economists have been less enthusiastic regarding the proposition that economics must take fuller account of real processes, psychology, and culture. The arguments of this paper indicate an inconsistency in the mainstream position. The acceptance of Coasean economics indicates that institutions matter. But Coasean comparative analysis fails to provide a full explanation of institutions. The need to compare *and* contrast institutions points to the value of reviving the Veblen-Hayek research program, and this requires further deviation from the use of representative agents with static and well-behaved utility functions. Renewed interest in an approach to economics that contrasts the evolution of alternative institutions is essential to both academic progress and the advocacy of reform-minded policy agendas.

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