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## Institutional economics and the concept of equilibrium

**Abstract:** *Institutionalism did exert a great influence both in the academia and in politics in the interwar period. However, after World War II, it lost ground and was pushed behind the scenes, although some distinguished exponents reached a remarkable success. In the 1970s, a new and very different kind of institutionalism developed. The paper inquires, through the use of the concept of equilibrium, into the evolution of institutionalism, from the classic, through the modern, to the new institutionalism.*

**Key words:** *equilibrium, evolution, institutionalism, methodology, neoclassical school.*

Although from the beginning of the nineteenth century until the interwar period, the United States was characterized by “pluralism” (Morgan and Rutherford, 1998) according to which “no one approach dominated the profession” (Backhouse, 1998, p. 85), it is also widely recognized that in the interwar period, the “old institutionalists”<sup>1</sup> were the “most visible, if not the dominant, group in American economics” (Morgan and Rutherford, 1998, p. 2).

Surely, they were very influential in politics and academia. It was not a proper “school”: the components of the movement, for instance,

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<sup>1</sup> I prefer to use the term “classic” or “original” institutionalism instead of the more common, but perhaps misleading, term “old” institutionalism.

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Thorstein B. Veblen, John R. Commons, John M. Clark, Wesley C. Mitchell, Walton Hamilton, Mordecai Ezekiel, and Gardiner C. Means, did not share the same program of research, and they had very different methods of investigation. Nevertheless, they had some common features, such as the role recognized to institutions and the emphasis given to empirical research.

In the postwar period, a number of changes took place: methodology in economics grew more and more formalized; econometrics gained ground becoming the mainstream economic way to be empirical; and moreover, neoclassical economics developed substantially and became widespread. In the meantime, institutionalism declined insofar as in the late 1950s a rather common opinion was that “there is not today anything which would be called either an institutionalist movement in economics nor even an institutionalist group” (Boulding, 1957, p. 1). Although they continued to have some influence on political grounds (Yonay, 1998), they gradually but unavoidably lost power in the academic world. As a consequence, “the younger generation of postwar institutionalists . . . remained mostly unknown to the economic community at large and to the wider intellectual public” (ibid., p. 59).

During the 1970s, a renewed interest for institutions appeared in academic debates and a new approach to economics developed: “New Institutional economics” (Williamson, 1975, p. 1). New institutionalism is different from the previous one especially with regard to methodology. The new approach is made clear in a book by Furubotn and Richter, where they underline the correspondence of new institutionalists’ methodology with the neoclassical approach, to such an extent that “institutionalism” is depicted “as extended neoclassical theory” (1997, p. 439). Indeed, it is widely recognized that

new institutional economics has generally identified itself as an attempt to extend the range of neoclassical theory by explaining the institutional factors taken as given . . . and . . . not as an attempt to replace standard theory. (Rutherford, 2001, p. 187)

New institutionalism is therefore far from the classic one: classic institutionalists deeply criticize traditional neoclassical economics and aim at founding a new economic science as an *evolutionary* science, distant from those assumptions that makes economics *static* and from *reality*. Among the aspects criticized, we find the concept of equilibrium, on which this paper is focused.

The concept of equilibrium is interesting for two main reasons: first, it allows us to underline some differences among the classic institutional-

ists here considered; second, it supports us in depicting the evolution of institutionalism from the early beginning to its later developments.

### **The relevance of the concept(s) of equilibrium**

The concept of equilibrium characterizes scientific reasoning in physics, biology, chemistry, and social sciences. The concept of equilibrium has always been very recurring and has become central in economic reasoning. As such, it has been and still is one of the most questioned and complex concepts in economics.

It would be far beyond the aim and scope of this paper to take into consideration the whole literature on the subject. What I limit myself to do in this section is to briefly take into account some main points concerning the concept of equilibrium in order to highlight the ways in which it is used in institutionalist analysis.<sup>2</sup>

In time, different attitudes toward the concept of equilibrium have emerged. On one hand, most economists recognize the importance of the concept of equilibrium: Schumpeter, for instance, writes that equilibrium is “the bare bones of economic logic” and that it renders “an indispensable service in clearing the ground for rigorous analysis” (1939, vol. 1, p. 68). Hahn maintains that “[w]herever economics is used or thought about, equilibrium is a central organizing idea” (1984, p. 43). A similar opinion is expressed by Milgate when he defines the concept of equilibrium as the “central organizing principle around which the whole of economic theory was organized” (1991, p. 235). Many other economists are, on the contrary, strongly critical of the concept: according to Robinson, for instance, “the metaphor of equilibrium is treacherous” (1956, p. 59); Hayek calls it “a somewhat unfortunate term” (1978, p. 184), whereas Kaldor underlines the “irrelevance of equilibrium economics” (1972).

No doubt, the concept of equilibrium has been and still is particularly controversial (Lawson, 2005). One of the main problems is that “equilibrium, despite its familiar sound, was and is an elusive concept because it can be variously defined” (Russett, 1966, p. 2); indeed, we can easily discern “a plethora of conceptions” (Lawson, 2007, p. 143). Furthermore, equilibrium not only has a great variety of meanings, but we can also distinguish between equilibrium as a *concept* and equilibrium as a

<sup>2</sup> The discourse will be maintained on a very general level. Therefore, a number of aspects will be deliberately neglected: differences between macro and micro equilibrium, stable and unstable equilibrium, general and particular equilibrium, and so forth.

*method* (Chick, 2007). It is easy, therefore, to understand why, in modern analysis, equilibrium is (still) an “elusive” and fuzzy concept.<sup>3</sup>

“Equilibrium” has become a fundamental part of what Samuels calls the “neoclassical research protocol” (2007, p. 192), and is widely considered “the neoclassical bailiwick” (Henry, 1983–84, p. 214). Mainstream economics is often identified “in terms of its use of the equilibrium concept” (Dow, 1996, p. 111), and the idea of (general) equilibrium is widely considered as part of the hard core of mainstream economics (Weintraub, 1985). As such, it is often considered as the (optimum) solution of mathematical models: “At its most general, we can say that equilibrium is a method of solving economic models. At a superficial level, an equilibrium is simply a solution to a set of equations” (Dixon, 1990, p. 356).<sup>4</sup>

In order to highlight how the institutionalists here considered deal with the concept of equilibrium, it seems useful to dwell upon the meaning of “balance.”<sup>5</sup> Two main connotations are worthy of being underlined.

<sup>3</sup> In time, various attempts to marshal and clarify the concept have been made (Backhouse, 2004; Machlup, 1958). Lawson (2005; 2007) grounds the possible reasons of the difficulty in a crucial misconception that occurred in economic analysis—that is, the confusion between the *theoretic* and the *ontic* conceptions of equilibrium (2007, p. 139). According to Lawson, it is possible to distinguish two main notions of equilibrium: (1) “system determinateness,” which refers to “the determinateness of particular representations or formalisations,” which is a theoretic conception (*ibid.*, p. 140); and (2) “balance or order,” which refers to “an aspect of the economy [the economists] are attempting to represent,” which is the ontic conception of equilibrium (*ibid.*, p. 140). Simplifying our reasoning, we may note that mainstream (neoclassical) economics uses mainly the *theoretic conception* of equilibrium, often considering it as a “method of solving economic models” (*ibid.*, p. 144), whereas heterodox economics uses the concept of equilibrium but—as stressed by Lawson—according to an *ontic* meaning; that is, the concept of equilibrium is understood as a “balance or form of order,” eventually without making a theory of it and/or departing cautiously from it. Joan Robinson is rather representative of this latter attitude (*ibid.*, pp. 144–145).

<sup>4</sup> Orthodox economics has been severely criticized for its “reliance on equilibrium thinking” (Denis, 2007, p. 262). But on second thought, we may note that it is not the concept of equilibrium in “itself” that has been object of criticism but rather the way equilibrium is used, “its *mode of deployment* in economics” (*ibid.*, p. 262, emphasis in original). The following quotation is rather representative: “when equilibrium means only mathematical solution the concept is robbed of any but syntactical meaning and has no economic content. But as a concept of a configuration which will persist unless disturbed—the meaning of equilibrium in ordinary language—I believe it has a useful analytical and descriptive role to play in economics” (Chick, 2007, p. 238).

<sup>5</sup> Lawson characterizes only heterodox economics with this meaning of equilibrium. His aim is to clarify the different meanings of equilibrium and to disentangle the intricate state of the concept. His focus is, therefore, on the “confusion in the employment of central categories, due in large part to a recurring failure to distinguish properties of models from properties of the social reality are thought to capture” (2007,

According to the first, equilibrium as “balance” is often connected with the idea of economics as a pure, exact science, just like physics. This way of understanding equilibrium and the economic science belongs, chiefly, to the “mainstream” neoclassical theory, economics being treated as analogous to physics, born from the Newtonian scientific revolution. By considering economic activity in terms of maximization, neoclassical economists characterize equilibrium, meaning “a balance of pleasure and pains,” as the aim of human behavior, whereas change is seen as an “activity directed to re-establishment of a broken equilibrium” (Hamilton, 1991, p. 42). In neoclassical economics, equilibrium refers to a static framework and often corresponds to an “optimum” (Hicks, 1965, p. 17; Zafirovski, 2002). The main distinguishing character of this conception is the “timeless dimension” of the analysis, according to which equilibrium outcomes are “*path independent*” (Lang and Setterfield, 2006–7, p. 199).

According to the second connotation, equilibrium as balance is related to the Darwinian contribution to natural and social sciences. With Darwin, evolution becomes the central idea, considered as an endless process of cumulative change; equilibrium is “an essential element of the system being considered,” a necessary condition for the survival of the system itself: it is still a balance of forces, but these forces are “of life and decay,” as Marshall put it (1920, p. 323). Also in neoclassical economics, one may say, there is “change”; but it is only expressed in terms of “quantitative and repetitive movement within a fixed universe” (Hamilton, 1991, pp. 27–28) and is directed toward (an optimum) equilibrium. Darwinian change is, on the contrary, a “non-theological process of cumulative growth.” The result of the change is not necessarily an optimum, but it can be either bad or good (Zafirovski, 2002, p. 568); no natural law guarantees the achievement of an optimum equilibrium. Wants and resources are variables that change not “by virtue of some natural law working without human agency” but “by virtue of influences that are endogenous to the human social system” (Stanfield, 1999, p. 234). Time and history become the pillars of this kind of analysis.

As we will see in the following sections, both these contents of “balance” are present in the classic institutionalists considered in the paper: the first—equilibrium as a balance of forces in a static framework—permeates Clark’s writings; the second content—equilibrium as a balance

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p. 133). Indeed, equilibrium understood as a “balance” is traceable also in orthodox writings, albeit used in a strictly theoretic and static framework and very different from the meaning given by Lawson in his analysis.

of life-and-decay forces embedded in a changing-evolving milieu—belongs to Veblen’s conception of equilibrium; both ideas of equilibrium are present to a certain degree in Commons’s writings, where they are subject to criticism.

### Classic institutionalists and the concept of equilibrium

#### *Veblen and moving equilibrium*

Veblen carries out a severe and broad criticism of what he considers the “preconceptions” of “traditional” economics. Among the criticized aspects, we find the concept of equilibrium. According to Veblen, in the writings of the “traditional” economists, even when dynamics is considered, the aim is the “determination of the outcome of the process under discussion rather than a theory of the process as such. The process is rated in terms of equilibrium to which it tends or should tend, not conversely” (1900, p. 256). Therefore, equilibrium is the final outcome of the process and it is not, on the contrary, the point of departure “for an inquiry into what may follow” (*ibid.*, p. 256).

Given this viewpoint, the only concept of equilibrium Veblen can reasonably conceive is that of “moving equilibrium” of forces. Veblen uses (albeit seldom) the concept of moving equilibrium as a metaphor when he wants to stress the complex and composite nature of what he is referring to. So, for instance, the industrial system is considered as “a wide-reaching organization of mechanical processes which work together on a comprehensive interlocking plan of give and take, in which no one section, group, or individual unit is free to work out its own industrial salvation except in active copartnership with the rest; and the whole of which runs on as a *moving equilibrium of forces in action*” (1919, p. 87, emphasis added). When dealing with the manifold phenomenon of sabotage, Veblen notes that only as a “comprehensive moving equilibrium,” it might be helpful “to preserve the business community from recurrent collapse or stagnation, or to bring the nation’s traffic into line with the general needs of the vested interests” (1921, p. 14).

Veblen’s moving equilibrium resembles Spencer’s (1937) and is close to the Darwinian idea of a necessary connection between equilibrium and change.

According to Spencer, evolution is a progressive movement toward an equilibrium where individuals change their characteristics and habits until they are perfectly adapted to circumstances and no more change is called for. A further evidence of the similarity between Spencer and Veblen, in



spite of the various existing differences (Hodgson, 1993, pp. 127–129), can be found in the following statement by Veblen:

There is no reasonable exception to be taken to the statement that the country's industrial system is forever *growing more extensive and more complex*; that it is continually taking on more of the character of a *close-knit, interwoven, systematic whole; a delicately balanced moving equilibrium of working parts*, no one of which can do its work by itself at all, and none of which can do its share of the work well except in close correlation with all the rest." (1921, p. 74, emphasis added)

The idea of a system considered as a coherent whole, made of several parts inclined to reach a moving equilibrium, certainly comes from Spencer,<sup>6</sup> even though in the United States the diffusion of the idea occurred through C.R. Henderson.

Hodgson envisages an analogy between the Veblenian handling of equilibrium and the modern concept of "punctuated equilibrium" (1996, p. 398). Following Gersick (1991), we can distinguish three different components of punctuated equilibrium—deep structure, equilibrium periods, and revolutionary periods. Deep structure is what is "highly stable" in a system: during the equilibrium periods, systems may adjust to compensate for internal or external perturbations without changing their deep structures, whereas in "revolutionary changes," there are no incremental changes that leave the deep structure intact; there are only changes that dismantle it. If I well understand Hodgson, all these aspects should be present in Veblen's thought. In Veblen, each institution, as a long-lasting system, can be considered a "deep structure," characterized by a certain equilibrium, a moving equilibrium, with adaptation in response to external or internal stimuli. An institution ceases to exist when a new one comes out; so, for instance, the modern captain of industry, "typified by the corporation financier, is one of the institutions that go to make up the new order of things" (Veblen, 1921, p. 21). But the new order of things has developed "progressively" (*ibid.*, p. 23), as

<sup>6</sup> In *First Principles*, Spencer writes: "Evolution, then, is a change from a less coherent to a more coherent form, consequent on the dissipation of motion and integration of matter. But, simultaneously with integration of the whole, there is differentiation and integration of parts in the whole. This is the second aspect of evolution. We have here to regard existences of all orders as showing progressive differentiation. The evolution of every aggregate must go on until a moving equilibrium, or equilibrium mobile, is established, since an excess of force which the aggregate possesses in any direction must eventually be expended in overcoming resistances to change in that direction, leaving behind only those movements which compensate each other, and so forming a moving equilibrium" (1937, pp. 291–292).



the outcome of a gradual, progressive process (ibid., p. 36). This does not seem, therefore, in accordance with the idea that “the deep structure must first be dismantled, leaving the system temporarily disorganized, in order for any fundamental changes to be accomplished” (Gersick, 1991, p. 19).

According to Veblen,

the situation of today shapes the institutions of tomorrow through a selective, coercive process, by acting upon men’s habitual view of things, and so altering or fortifying a point of view or a mental attitude handed down from the past. (1934, pp. 190–191)

Hodgson notes that

as Veblen recognised, the “selective, coercive process” of institutional replication is not always confined to a fixed groove. Institutions change, and even gradual change can eventually put such a strain on a system that there can be *sudden* outbreaks of conflicts and crisis, leading to a significant change in attitudes, conventions, and social practices. (1996, p. 398, emphasis added)

Actually, the word “sudden” is very rare in Veblen’s writings, and he does not seem to take it in particular account:

What underlies and has brought on this bent in the temper of the civilized peoples is a somewhat intricate question of *institutional growth*. . . . [T]here may come an abrupt term to its paramount vogue, through some precipitate sweep of circumstances; *but it did not come in by anything like the sudden intrusion of a new invention in ideals—after the fashion of a religious conversion nor by the incursion of a hitherto alien element into the current scheme of life, but rather by force of a gradual and unintended, scarcely perceptible, shifting of emphasis between the several cultural factors that conjointly go to make up the working scheme of things* (1918, pp. 12–13, emphasis added)

Or, again,

*The [higher leisure] class cannot at discretion affect a sudden revolution or reversal of the popular habits of thought with respect to any of these ceremonial requirements. It takes time for any change to permeate the mass and change the habitual attitude of the people; and especially it takes time to change the habits of those classes that are socially more remote from the radiant body.* The process is slower where the mobility of the population is less or where the intervals between the several classes are wider and more abrupt. (1934, p. 104, emphasis added)

According to these statements, change and growth are slow and gradual processes; thus, one of the important characterizations of punctuated equilibrium seems to be missing.

*Commons: managed order versus equilibrium*

Although Commons, like Veblen, is rather critical of traditional, especially neoclassical, economics, he does not completely abandon the insights of orthodox theory (Gruchy et al., 1957, pp. 21–26; Rutherford, 1994); rather, he considers institutional economics as a development from traditional economics,<sup>7</sup> able to overcome a number of its faults and shortcomings. Traditional theories focus on the relation of man to nature, and the result is “the materialistic metaphor of an automatic equilibrium, analogous to the waves of the ocean, but personified as ‘seeking their level’” (Commons, 1931, p. 652).

Commons is deeply critical of the idea of mechanical or materialistic equilibrium (ibid., pp. 656–657). According to him, “there is no invisible hand about it, no natural equilibrium of forces of nature that augments the national wealth by mere unguided self-interest” (1923, pp. 116–117). It is not an invisible hand that can harmonize the self-interests of different people, but a “national economic policy,” the presence of state, rules, laws, the collective action. The idea of “equilibrium” is opposed to the idea of a “managed order”:

Sometimes anything that is “dynamic” instead of “static,” or a “process” instead of commodities, or activity instead of feelings, or mass action instead of individual action, or *management instead of equilibrium*, or control instead of laissez faire, seems to be institutional economics (1931, p. 648, emphasis added)

For Commons, equilibrium is what can take place if a system is left to move freely; it is the outcome of the working of an invisible hand. Commons is clearly inspired by the American sociologist Lester F. Ward who considered “institutions,” government above all, as the result of the social order and the only means for controlling “social energy” (Russett, 1966).

Traditional economics, built in a faulty framework considered unchangeable, is unable to understand and explain real phenomena. So, for instance, traditional economics is based on the faulty assumption of

<sup>7</sup> Commons maintains, for instance, “I do not think that institutional economics, defined as collective action in control of individual action, is contrary to the so-called pure economics of the past, which is individual action without collective control. It is a continuation of pure economics into a higher degree of complexity” (1936, p. 241, note 7).

“continuous full employment of all the factors contributing to the production of wealth” (Commons, 1937, p. 681); accordingly, equilibrium of all the factors is guaranteed by the automatic movement of prices. “But,” Commons goes on, “when the assumption of continuous full employment is tested by investigations which show that all of the factors are sometimes idle or slowed down at the same time” (ibid., p. 681), the investigator has to formulate other hypotheses.

Indeed, because the world is not a perfect milieu and its working rules are not in “foreordained harmony” of interests, it becomes vital to inquire how to manage conflicts of interests, the mutual dependence of all the parts composing the “milieu,” and how to guarantee an order of all such parts and different interests; this is, according to Commons (1931), the ultimate aim of institutional economics.

Economics should be an evolutionary science; Commons’s evolutionism is in many aspects very close to Spencer. Commons thinks that the evolution of an institution implies the passage from homogeneity to heterogeneity, and, like Spencer, has an idea of equilibrium as a necessary balancing between opposed forces:

A mob may have common desires. But, as long as its individuals are acting each for himself at cross purposes, their individual forces, no matter how powerful, will end only in equilibrium. To accomplish results they must be organized, that is, guided by one man (Commons, 1899, p. 165)

In a democratic country, the guide cannot be only one man, but the state,

the great constitutional safeguards which we have asserted since the time of Magna Charta have been adopted in order to place a subordinate class on an equilibrium with a dominant class. It is in this way that trial by jury has had to be reasserted whenever a new social class has emerged. And it is partly by restoring trial by jury that the great third class, the public, is now beginning to assert its right to hold the balance between two struggling classes. (Commons, 1908, p. 764)

There is indeed an important difference between Commons’s and Spencer’s ideas of equilibrium. Even though Spencer thought of a necessary stable equilibrium between destructive and preservative forces, the implication of his theory “was that evolution, and human progress, would at some stage come to a halt in a perfectly equilibrated world” (Kingsland, 1988, p. 177). This could not be Commons’s opinion, if I rightly understand his critical attitude toward Marxian historical materialism:

A recent writer (O. Lange, in *The Review of Economic Studies*, June, 1935) holds that economic theory does not have within itself a principle

of evolution, and must follow Karl Marx in a theory of historical materialism in order to derive a theory of economic evolution. But I reduce Marx to a theory of efficiency measured by man hours as an essential part of economic theory, although usually measured by dollars. And I find economic evolution in the changes of custom, the changes in citizenship, the changes in sovereignty, as well as in technological changes. (Commons, 1936, p. 245)

Following Darwin, Commons does not see any teleological process in which the fittest institutions survive through natural selection.

*Clark: equilibrium as a starting point*

Clark, contrary to Veblen and Commons, does not criticize neoclassical economics but considers it pivotal also for institutional economics. In many of his writings, Clark develops his reasoning according to marginal rules. But, at the same time, he is an authentic institutionalist; he reflects on the role of government (1916), on the limits of laissez-faire (1914), on the role and function of law (1925a; 1925b), and on the importance and variety of institutions.

Neoclassical analytical tools are considered by Clark as the necessary starting point for any further consideration and scientific improvement; the marginal method is taken as only one phase of economic study, a phase that becomes secondary as economic problems become more complex.

Accordingly, the concept of equilibrium is often used as the outset from which he develops his reasoning on crisis, cycles, markets, and prices and is remarkably widespread in his writings. According to Clark,

studies of equilibrium are not end-products, and not to be construed as finished pictures of the actual world. . . . They are themselves tools of analysis and methods of approach to a picture too complicated ever to be finished. (1936, pp. 3–4)

On the other hand, he notes that

while a picture of perfect equilibrium deals in its way with forces which are at work in the actual work, the form in which it presents these forces will almost inevitably need to be modified when we move on to the task of studying them as they actually operate. (ibid., p. 4)

Clark is perfectly aware that there are a number of troubles connected with the use of the concept of equilibrium (1934), but it still remains a good departure point:

Modern inductive and quantitative studies are already making use of bits of the equilibrium theory as hypotheses, although they have usually had to be reformulated to adapt them to the requirements of verification.

Even in the study of disturbances themselves, pictures of the conditions necessary to equilibrium often furnish a starting-point in the analysis of why equilibrium is not reached (1936, p. 5)

Rather, it is an essential tool. In fact,

when equilibrium theories are used as devices to analyze actual conditions which do not follow the equilibrium model, one curious and interesting result sometimes follows—namely, a fuller development of the equilibrium theory itself. The conditions *necessary* to equilibrium often have to be more carefully and rigorously stated than ever before, in order to show how actual conditions differ and why they lead to a different result. (ibid., p. 5, emphasis in original)

Clark makes the example of the theory of imperfect competition that obliges economists to carefully define the necessary conditions for perfect competition (1940, p. 241).

The concept of equilibrium is a fundamental element and tool for the economist who wants to understand the real world, and, as such, it must not to be dropped, yet it must be supplemented with something else. This seems to be clearly stated when orthodox economics is compared with institutionalism:

Orthodox economics undertakes to interpret equilibrium: Veblen undertakes to interpret progressive change. And in the social world this is much the same as saying that orthodox economics studies the assumptions of contentment and Veblen the assumptions of discontent, both of which are undeniable facts. Since undeniable facts are difficult to ignore, the net result is very largely to call them by different names. (1921, p. 132)

According to Clark, equilibrium and progressive change are “undeniable facts,” both are necessary to approximate the understanding of the real world.

### **From classic to new institutionalism: something lost?**

Veblen, Commons, and Clark belong to what may be considered the golden age of institutionalism, when institutionalists did really exert a great deal of influence.<sup>8</sup>

<sup>8</sup> In the academia, two of the main universities in the United States were institutionalist strongholds: Columbia University with, among others, Mitchell and Clark and the University of Wisconsin with Commons; the other two main universities were neoclassical: Harvard and Chicago. After 1926, as Rutherford observes (2007, p. 291), many institutionalists were involved in shaping the U.S. economic, industrial, or social

It is after World War II that the gradual but inexorable decline of institutionalism began. Notwithstanding the fact that some of the younger generation of institutionalists reached a remarkable success (most notably Clarence E. Ayres, Simon S. Kuznets, John K. Galbraith, and Gunnar Myrdal), their case remained rather isolated; most of the postwar institutionalists stayed mainly unknown (Mark R. Tool, J. Fagg Foster, and Wendell C. Gordon). At that time, institutionalists proved unable to face the pressing rise of the new, more formalized and abstract approach to economics, and objections were increasingly raised against them. A striking example is given by the deep criticism by Koopmans (1947) on the question of measurement. In his discussion of the book by Burns and Mitchell on business cycles (1946), Koopmans criticized the authors' method and results pointing out, "there is no sign in the book of the awareness of the problems of determining the identify-ability of, and measuring, structural equations as a prerequisite to the practically important types of prediction" (1947, p. 167). According to Koopmans, the problem was that "the decision not to use theories of man's economic behavior, even hypothetically, limits the value to economic science and to the maker of policies, of the results obtained or obtainable by the methods developed" (*ibid.*, p. 172).

Koopmans was not an isolated case: institutionalists were increasingly criticized, especially on the basis of the presumable missing theory:

Positively, [institutionalism] favoured broad descriptive, statistical, and other empirical studies; negatively, and less admirably, it made rather less than amiable attacks on neo-classical economics as static, taxonomic, tautological, and teleological. This was not an attack on the use of mathematics, as such, but on deductive methods and even naively on "theory" in general. (Elliot, 1954, p. 482)

The American Institutionalists were not theoretical but anti-theoretical. . . . Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory or fire. (Coase, 1984, p. 230)

After the golden era and despite the unmistakable decline, those few modern institutionalists who tried to strenuously defend and take institutionalism alive had to face especially this widely criticized supposed atheoretical aspect of institutionalism. Institutionalists' writings were considered full of descriptions, data, and history but absolutely lacking any theoretical structure and could hardly be considered grounded on

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policies at governmental level (Commons, Mitchell, Clark, Rexford G. Tugwell, and many others).

a proper theory. The critique sounded like this: how to pretend to have theory without an analytical construction?

Institutionalists proved unable to answer this question. They knew that their approach was open to criticism. Ayres, for instance, already in 1935, had complained that

the most serious defect of “Institutional” economics is its failure to meet this challenge. It has either dismissed economic theory with contempt or ignored it altogether, and has thus richly merited the “Neo-classical” jibe which declares it mere “bad economics.” (1935, p. 172)

Institutionalists criticized the neoclassical approach to economics but they did not go further, as clearly underlined by Burns:

It is unfortunate that the reaction against neoclassical economics has taken the negative form of a claim that economic theory is useless, instead of the more positive form of suggestions for an economic theory that could replace the present prevailing systems. (1931, p. 85)

Such failure remained over time. Postwar institutionalists share with the classics a deep criticism of neoclassical economics, although we may note a slight but interesting difference: neoclassical theory is no longer criticized for being based on *wrong* assumptions as before (Ayres, 1936; Veblen, 1900) but for being *insufficient* to face actual real challenges (Galbraith, 1973b; Gruchy, 1982; Myrdal, 1972).

A minimal role of equilibrium is stressed by Ayres: “equilibrium is just equilibrium—‘Just’ in the sense of ‘only’—and provides no clue to economic justice” (Ayres and Heflebower, 1958, p. 487). Equilibrium is an oversimplification of the real world and is, as such, useless:

The whole theory of price equilibrium derives its significance from those assumptions; and since the assumptions are at variance with modern knowledge, the whole price-equilibrium theory of the economy stands by itself, aloof from the general theory of social organization toward which the other social sciences have been moving. (Ayres, 1953, p. 279)

Particularly critical toward the neoclassical theory is Galbraith, who underlines that

Neoclassical . . . economics, though providing unlimited opportunity for demanding refinement, has a decisive flaw. It offers no useful handle for grasping the economic problems that now beset the modern society. (1973b, p. 2)

But he also recognizes that some assumptions of the neoclassical approach, most notably those that are required by an equilibrium framework,



may be of some utility: according to Galbraith, the concept of equilibrium is valid only if the assumptions that traditional theory requires (perfect competition, maximizing attitude) are valid. These assumptions may resemble, although only *roughly* (1973a, p. 29), a part of the economic structure of the market (the part made of agriculture service industries, artistically oriented industries, all those industries that are not susceptible to large-scale organization. See Galbraith, 1957, p. 126; 1973a, p. 29; 1988, p. 373). But, of course, there are many and important parts of market structure that do not conform to the traditional theory precepts. In general, what characterizes real economies is not the concept of equilibrium we find in textbooks, with its assumptions (Galbraith, 1954), but disequilibrium, through which it is possible to deal with the difficulties and problematic circumstances of the real world (Galbraith, 1947). In real markets, prices do not tend to normally conform to “profit maximizing levels” (Galbraith, 1957, p. 127); policies may have different and also distortive effects (*ibid.*); consumers are not the sovereigns of the market but rather producers have the power to determine the trend of the market (Galbraith, 1973a, p. 29; 1970). When one deals with real markets, equilibrium can only be a “mirage” (Galbraith, 1947, p. 292).

This attitude toward equilibrium was not new. Kuznets, for instance, in his analysis of business cycles, had already maintained that “[the] use of the concept of equilibrium, as a condition under which the problem of pricing becomes determinate, is in itself not objectionable” (1930a, p. 394), but we should be aware of the fact that this idea “has not counterpart in generalized reality” (*ibid.*, p. 400). Nonetheless, he did not completely discharge neoclassical assumptions, but, rather, he aimed at enriching the clearly insufficient body of static economics (1930b, p. 441).

A more radical position is that of Myrdal, who started as a neoclassical and then became—as he writes—an institutionalist economist (1978, p. 772). Myrdal underlines that if one wants to consider the “dynamics of social systems it is necessary to inquire into the circular causation and interdependence of conditions,” where “there is generally no equilibrium in sight” (*ibid.*, p. 774). According to him, “the seemingly greater precision in conventional economic analysis is only attained by ignoring a whole world of relevant things” (*ibid.*, p. 776), noting also that

I should add that when institutional economists are critical of the closed models of their conventional colleagues, this does not . . . imply that we are hostile to models and theories. But we want the models and theories—conceived by us as logically integrated systems of questions directed to the empirical reality around us—to be more adequate to this reality. (*ibid.*, p. 776)

Myrdal, in the 1970s, was sure that the institutional approach could come to prevail:

I believe that in the near future it is destined to win ground at the expense of conventional economics, and not primarily because of the strength of its logic. Institutionalism will become more prevalent because a broader approach will be needed for dealing in an effective way with practical and political problems that are now towering above and threatening to overwhelm us. (*ibid.*, pp. 779–780)

The same optimism was shared by Galbraith, who maintained that neoclassical economics was “in the process of being replaced now . . . [since] circumstances are the enemy of neoclassical economics” (1973a, p. 28). The world was changing and was imposing new challenges. Traditional economics, with its notion that “the individual is all-powerful, that the modern corporation is an automaton, subordinate to the market, can’t survive” (*ibid.*, p. 28). It was, according to Galbraith, “too in contrast with commonsense,” because it neglected some important “practical problems with which society, including the modern state, is faced” (*ibid.*, p. 28): unevenness in growth, growing inequality of income distribution, problems of coordination of different sectors, and problems of environmental disharmony. Economics should be, on the contrary, “in constant accommodation to social, political and institutional change and not, certainly, as a search for, an expression of, unchanging truth” (Galbraith, 1988, p. 373). The problem is that “economics is insufficiently normative [and moreover] model building has become an end, not a means” (Galbraith, 1973b, p. 1).

Galbraith—as well as Myrdal—was wrong. Institutionalism did not prevail, and the neoclassical architecture did not disappear from economic textbooks; rather, it emerged as the *mainstream approach* to economics. Institutions, like any other aspect that could pollute pure analysis, were pushed to the periphery of economic study. Postwar institutionalism remained behind the scenes, developed by a few economists who, notwithstanding the importance of their contributions, did not create a strong and successful opposition.

In the 1970s, something changed and institutions turned again to draw the attention of a large part of economists: with his book published in 1975, Williamson officially establishes what became known as “new institutional economics.”

*New* institutionalists do not try to contrast neoclassical economics; on the contrary, their starting points are often the very neoclassical assumptions (Alchian, 1953; Alchian and Allen, 1964; Alchian and Demsetz,

1973; De Alessi, 1983; Demsetz, 1968; North, 1971) that are no way abandoned but integrated and enriched (Alchian, 1950; Demsetz and Lehn, 1985; North, 1971; Riordan and Williamson, 1985; Williamson, 1974, 1991, 2000). Neoclassical theory is (feebly) criticized for being incomplete and not taking account of a number of important issues such as transactions costs, property rights, contractual relations, and imperfect information (Alchian and Demsetz, 1973; Demsetz, 1997; Williamson et al., 1975), but, once provided the due additions, it is not at all discharged (Alchian, 1965; De Alessi, 1966, 1967, 1983). Given this viewpoint, it is not surprising that the concept of equilibrium plays an important part in their analysis; for instance, (the neoclassical) equilibrium framework is often considered as the necessary starting point of their reasoning (De Alessi, 1983, p. 68; North, 1984, p. 255) or the final outcome of their analysis (Williamson, 1974).

### Concluding remarks

By highlighting the way in which the authors considered in this paper deal with the concept of equilibrium, it is possible to discern important differences in their attitudes toward neoclassical theory. Classic institutionalists—in particular, Veblen and Commons—strongly criticize neoclassical economics and believe in the necessity of developing an alternative approach. According to Veblen, a proper modern science should inquire into “the phenomena of life” and be “occupied about questions of genesis and cumulative change” converging “upon a theoretical formulation in the shape of a life-history drawn in causal terms” (1909, p. 627). According to Commons, economics should become a theory of reasonable value and should not separate “ethics, public welfare, or national public interest as a postscript, different from economic theory” (1936, p. 237). Both Veblen and Commons reject the traditional concept of equilibrium, conceived as a “balance” in a static framework and therefore not fitted for understanding moving, evolutionary forces, including human nature.

After Veblen and Commons, those economists who believe in the importance of taking institutions into account, called *modern* institutionalists in this paper, criticize neoclassical economics but mainly as far as it is insufficient to deal with real problems. In their writings, the concept of equilibrium is often used as the best proof that traditional theory is disconnected from reality. They think that the gap between the neoclassical theoretical abstractions and the emergence of real problems

would naturally weaken that approach and eventually make it obsolete and marginal.

Finally, new institutionalists criticize neoclassical economics insofar as it does not take some institutional aspects into consideration; accordingly, they undertake to enlarge the traditional models and assumptions. They do not want to propose an alternative theory to the mainstream but only to enrich it, loosening some assumptions that were clearly too tight, such as, for instance, those related to the theory of firm (Alchian, 1965; Demsetz, 1997). They do not question the utility of the traditional analytical tools, including the tool of equilibrium; on the contrary, they defend neoclassical theory against possible attacks (Alchian, 1965). New institutional economics develops from neoclassical theory, which is absorbed as a part of their analysis (Williamson, 2000). Institutionalism has, therefore, developed from a very strong (Veblen, Commons) through a mild (Galbraith, Myrdal) to a negligible (De Alessi, Alchian) opposition to the neoclassical methodology. From the original belief that a large part of the traditional theory should be discharged and replaced by something new, we pass to the idea that traditional theory is not wrong but only unfitted or insufficient for the economists' work.

Indeed, the change of institutionalists' attitude toward neoclassical economics, underlined in the paper through the special lens of the concept of equilibrium, is visible already among the classic institutionalists: contrary to Veblen and Commons, Clark does not criticize the neoclassical "box of tools" and does not aim at building an alternative theory, but thinks it is sufficient to "fill the gap" of its narrow assumptions. As we have seen, this is also what new institutionalists think.

Institutionalism as an alternative approach to economics does not exist anymore; it has become a part—although with some important differences—of neoclassical economics.

In the passage from the *classic*, through the *modern*, to the *new* institutional economics, it seems that something was lost: the very critical attitude toward traditional economics from which the original institutional economics had risen has been replaced by a rather shared endorsement of the neoclassical tools and approach.

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