Non-neoclassical economics from late 19th century to 1930s

- Historical school of economics
- Institutional economics (or institutionalism)
- Austrian school of economics

- From 1930s on, neoclassical economics has marginalized both schools, but from 1890s to 1930s, they had been very popular among economists.
- From modern perspective we call those currents as non-orthodox, heterodox (approaches to economics), since neoclassical economics is treated as orthodox.

‘Heterodox economics’: late 19th/early 20th century

- Late 19th century and first 3 decades of the 20th century
- Time of PLURALISM IN ECONOMICS
  - neoclassical economics (itself divided into 2 camps – Marshallian and Walrasian)
  - Historical school of economics
  - Institutional economics
  - Marxian economics
  - Austrian school of economics

‘Heterodox economics’: late 19th/early 20th century

- Neoclassical economics since 1940th has become mainstream, orthodox approach – other currents have been marginalized

- Some of them survived as heterodox schools (Marxian econ., Austrian school), others died out (Historical school), yet others have been largely transformed (‘Old’ Institutionalism and New Institutional Economics)
- But the mainstream was influenced (sometimes much) but the heterodox approaches

Historical school of economics

- Originated in Germany in 1840s
- Mainly German economists, but the school active also in England in late 19th/early 20th century
- Very diverse views of the members of the school
- United by the very critical attitute to (neo)classical economics

Historical school of economics

- Two generations: ‘older’ and ‘younger’ historical school

- Older historical school
- Representative economist:

  Friedrich List (1789-1846), German thinker

Older historical school of economics

- Main arguments of Friedrich List
- (Neo)classical economics is not an universal framework – you can not apply it all cultures and times

- Recomendations of A. Smith, D. Ricardo, J. S. Mill etc. (e.g. free trade, laissez-faire etc.) can be usefull for industrial England, but are irrelevant for poor Germany (economy still based on agriculture)

Older historical school of economics

- List advocated economic nationalism – policies should be based on nation-specific interests and needs
- Contrast with (neo)classical economics, which is focused on interests/preferences of individuals
- Economics should use historical methods of inquiry (induction) and abandon deduction (logic, mathematics)

Older historical school of economics

- Economics should <u>not</u> strive for discovering <u>universal economic laws</u> to be applied in all times and cultures. Economists should rather formulate the laws governing the economy on <u>different stages or levels of development.</u>

- These laws are not universal, they are stage-of-development-specific

Older historical school of economics

- According to List laissez-faire policy was not appropriate for such countries as Germany and the US
- State should control and govern the process of development of economies
- Proposed protectionist economic policy – tariffs and restrictions on imports in international trade (to protect smaller and underdeveloped economies)

Younger Historical School

- Gustav Schmoller (1838-1917)
- Similarly criticised universalism of neoclassical economics
- Produced no theory, focused on collecting data (induction), historical description
- Recommended various social reforms, state socialism which should be directed by aristocracy

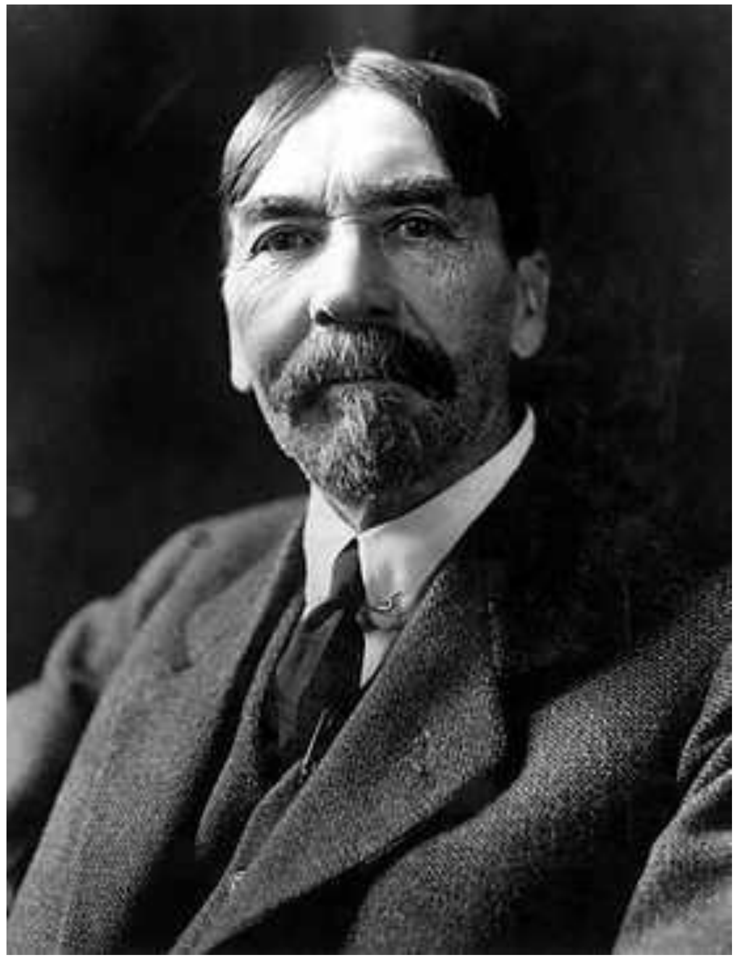
Younger Historical School

- Effect of the popularity of Historical School in Germany – very little influence of neoclassical economics in Germany (underdevelopent of economics evident up to 1950!).
- In 1880s-1890s involved in the famous *Methodenstreit* (conflict over methods) with advocates of the use of deduction in economics (neoclassical economics, Austrian school)
- Long (two decades) methodological debate, ultimately won by neoclassicals/Austrians.

Old Institutional Economics

- Heterodox school (active: late 19th century – 1940s)
- Mainly US economists
- Marginalized in 1940s by neoclassical school
- Quasi-institutionalism (G. Myrdal, J. K. Galbraith) – 1950s-1970s
- Revival or synthesis with neoclasical economics – New Institutional Economics (since 1980s)

Thorstein Veblen (1857-1929)



Thorstein Veblen (1857-1929)

- *Theory of the Leisure Class*, 1899
- ‘the most original and penetrating economic and social <u>critic of American capitalism</u> that the United States has ever produced’.
- Unusual style of writing; terms like ‘conspicuous consumption’, ‘leisure class’, ‘captains of the industry’, etc.
- Economist and sociologist
- Veblen’s economics:
  - Criticism of neoclassical economics
  - Analysis of capitalism
  - Possible scenarios of the future development of economics

Criticism of neoclassical economics

- Wanted to abolish the entire structure of neoclassical economics and rebuild a unified social science from economics, anthropology, sociology, psychology and history.

- NE is not scientific due to several reasons

Veblen’s criticism of Neoclassical Economics

<u>NE is not scientific:</u>

a) Based on the wrong assumption, that there is a harmony in the economic system

While in real economies:

1. there are monopolies;
2. prices are higher than competitive prices;
3. competition among large corporations leads to wars among countries;
4. and the actions of captains of industry lead to mass unemployment and depressions.

Veblen’s criticism of Neoclassical Economics

b) Equilibrium concept is rather normative (ethical), than positive (scientific)

c) Assumes that the economy is static, non-evolving entity.

Economists should also study factors they assume to be constant – such as tastes, preferences, technology, organizational arrangements of the society and the economy etc.

Veblen’s criticism of Neoclassical Economics

d) Based on the wrong assumptions about the human nature

According to NE humans are driven by the desire do maximize pleasures and minimize pains. This is hedonistic psychology.

This assumption ignores the developments made in psychology, sociology and anthropology. According to Veblen people are guided by a wide array of motives (various instincts, habits, obligations, duties etc.)

Veblen’s analysis of capitalism

- Economics should be a study of the evolving institutional structure of the economy and the society
- He defined institutions as <u>habits of thought that are accepted in the society</u> (or by different classes of society) at any particular time.
- Institutions are widely-shared habits, preferences, norms and the like – in general some kind of a mental culture of the society.

Veblen’s analysis of capitalism

- For Veblen, the most important institutions are <u>instincts</u> :

- parental instinct,
- instinct of workmanship (of hard work),
- idle curiosity,
- instinct of acquisition (greediness, money-grabbing instinct).

Veblen’s analysis of capitalism

- Those instincts create certain tensions in the economy and society.
- Instincts of workmanship and idle curiosity lead to production with great efficiency of high quality products.
- But, the instinct of acquisition (maximization of profits) leads to behavior that benefits only the individual, even though it might have disastrous consequences for the society (lower production, low quality goods).
- In the economy, in every historical period, there is a conflict, tension between the instincts of this two kinds (workmanship and idle curiosity vs. acquisition).

Veblen's analysis of capitalism

- In capitalism, there are <u>two</u> different habits of thought (institutions):

  1) for workers and engineers, and

  2) for the businessmen (or captains of industry).
- Instincts of hard work and idle curiosity are prevailing in the class of workers and engineers. <u>Concerned with high production, low prices, high quality.</u>
- Captains of industry (businessmen, owners of capital) are driven mainly by the instinct of acquisition. <u>Concerned with profits, higher prices, restricting the volume of production</u>.
- **So there is a basic, fundamental conflict in capitalism between capitalists and both workers and engineers.**

Veblen on consumption patterns in capitalism

- Predatory instinct – people want to compete, to be held in high esteem, to be admired etc.

- Predatory and acquisition instincts are realized in modern capitalism by methods of <u>conspicuous consumption</u> and <u>conspicuous leisure</u>.

Conspicuous activities

- Conspicuous consumption – consumption attracting attention of others, luxury consumption
- Conspicuous leisure – leisure attracting attention of others, involving some highly priced commodities. Includes parties, sports, higher education etc.

Veblen on leisure class

- Leisure class – wealthy class, members do not have to work physically in the productive sector,
- Examples: owners of firms or engaged in ‘money-related’ occupations like high management, banking, finance, law etc.

Veblen on the long-run tendencies in capitalism

- Patterns of conspicuous consumption and leisure will spread out throughout the society; there will be much waste from those phenomena and there will be increased advertising and marketing costs.

- Increased flow of goods that do not satisfy real human needs.

Veblen on the future of capitalism

- If the working class and engineers would gain the control of the system, than the progress is possible (in terms of contributing to satisfying real human needs).
- This is possible through a socialist-like revolution.
- The reason for the revolution could be <u>relative poverty</u> of the working class. Discontent on the part of the working class that they can not consume as much as the leisure class.

Veblen on socialist revolution

- This would be a collapse, an end of capitalism not because of its failures (like growing unemployment, depressions, increasing absolute poverty) as Marx thought, but rather in the effect of its success
- Capitalism is continuously growing, and absolute standard of living is growing, but the <u>relative poverty</u> is also growing.

Veblen on future of capitalism

- Future is not determined, it is open-ended
- Possible visions of the development of capitalism in the long run, according to Veblen:

1. socialist revolution
2. technocratic revolution
3. turn to nationalism and police state

Summary of Veblen’s thought

1. critic of capitalism and neoclassical economics
2. considered by many as sociologist rather than economist
3. his contribution can be considered as complementary to neoclassical economics
4. his system was literary described with no model or theory in any strict sense
5. his psychology of instincts was soon rejected by psychologists
6. did not influence mainstream economics much, but managed to convince economists to do more empirically-oriented work
7. his conclusions are rather not suitable to empirical testing; writings are a mix of positive and normative statements

Other members of ‘Old’ Institutionalism

- Wesley Mitchell (1874-1948), American econ.
- Created *National Bureau of Economic Research* (NBER) (1920)
- Criticized neoclassical economics for being too abstract
- Studied business cycles; relied on empirical analysis without reference to any theory
- ‘Measurement without theory’ approach

Other ‘Old’ Institutionalists

- John R. Commons (1862-1945), American econ.
- Contributed to social reforms of labour market and social welfare programs
- Rejected laissez-faire policies, but claimed that capitalism is superior to other economic systems
- Precursor of the idea of ‘welfare state’
- Capitalism needs various interventions of government if it is to be a fair and just system

John R. Commons

- Prepared propositions for several social reforms:
  - Public regulation of safety in the work place
  - Public regulation of utilities (provision of water, electricity, transportation etc.)
  - Unemployment insurance
  - Social Security-type retirement programs
  - Regulations about child labor and minimum wage
- Up to 1930s – all considered as radical
- Hoever, many were introduced in 1930s in US (during the Great Depression; policy of the *New Deal*)

John R. Commons

- Tried to combine economics with law and history
- Used institutionalism to support social reforms of capitalism
- Thought that economics should interested in dynamic, evolutionary perspective (like Veblen)
- No influence on neoclassical economics