To the Graduate Council:

I am enclosing herewith a dissertation written by John Robert Sellers entitled "The Institutional Economics of Walton Hale Hamilton: Sources, Nature, and Influence." I have examined the final copy of this dissertation for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, with a major in Economics.

Hans E. Jensen,
Major Professor

We have read this dissertation
and recommend its acceptance:

Accepted for the Council:

Associate Vice Chancellor
and Dean of The Graduate School

# THE INSTITUTIONAL ECONOMICS OF WALTON HALE HAMILTON:

# SOURCES, NATURE, AND INFLUENCE

A Dissertation

Presented for the

Doctor of Philosophy

Degree

The University of Tennessee, Knoxville

John Robert Sellers

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To Dr. Hans E. Jensen, for giving me the opportunity and guidance to do this work.

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## Abstract

In December 1918 an article entitled "The Institutional Approach to Economic Theory" was presented at the annual meeting of the American Economics Association meetings. It is believed by some historians of economic thought that this was the formal beginning of a distinct intellectual movement that came to be known as "institutional economics." The author, Walton Hale Hamilton, was an influential economist, social philosopher, policy-maker during the interwar years and the New Deal, and legal scholar in the area of Public Law. He was a prolific writer of both popular and scholarly articles. Despite Hamilton having been a leading figure in institutional economics, little has been done to analyze Hamilton's contribution to the body of institutional economic theory. It is the purpose of this dissertation to provide such an analysis.

The thesis of this study is that Walton Hamilton advanced a distinctive approach to institutional economics. Three main questions are addressed with regard to Hamilton's work in institutional economic theory. First, what were the sources and origins of his institutional economics? Second, what was the nature of his institutional approach to economic theory? Third, what was the extent of his influence on institutional economics as an ongoing school of thought?

The results of the study suggest the following: First, Hamilton developed his institutional economics with Charles H. Cooley as his primary inspiration. Second, Hamilton advanced a holistic/evolutionary approach to economic theory that made the analysis of actual economic problems central to the development of theory. Third, in spite of the fact that Hamilton inspired other notable institutional economists, such as Clarence Ayres, the distinctive features of his work appear to have gone largely unrecognized by modern-day institutionalists.

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# CHAPTER 1

## INTRODUCTION

Today the American contribution to heterodox economic thought commonly referred to as "institutional economics" is most often associated with the names Thorstein Veblen, John R. Commons, Wesley Mitchell, and Clarence Ayres.[1] Rarely does one find a reference to Walton Hamilton. The overall lack of recognition notwithstanding, Hamilton has been credited with having popularized the title of "institutional economics,"[2] as well as having been the "chief promoter" [Dorfman in Hamilton 1974, p. 28] and "acknowledged intellectual leader" of the "American institutionalist school" [Breit and Culbertson 1976, p. 11] during much of the 1920s and 30s.

As the existing summaries of Hamilton's career indicate, Hamilton held prominent positions in both academe and government, was a colleague of several prominent economists, and produced numerous articles and books on the theory and application of institutional economics.[3]

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[1]. See for example [Landreth and Colander 1989, pp. 392-399].

[2]. Hamilton's presentation of "The Institutional Approach to Economic Theory" at the 1918 meeting of the American Economics Association marked the first appearance of "institutional economics" as a formal title.

[3]. Joseph Dorfman provides the most extensive discussion to date of Hamilton's work in Industrial Policy and Institutionalism, [Hamilton 1974, pp. 5-28]. See also

Furthermore, having been a prolific writer of both popular and scholarly articles and books on a wide variety of subjects, Hamilton is said to have achieved "national acclaim as an economist, political scientist, legal scholar, and expert on the administrative functions of government" [Dorfman in Hamilton 1974, p. 5]. For these reasons it is surprizing that Hamilton's contribution to the body of institutionalist economic thought has received little more than an occasional footnote regarding his coining of the term "institutional economics." The overall purpose of this dissertation is, therefore, to help fill this intellectual void. Toward accomplishing that end I will provide an examination of the sources, nature, and influence of Hamilton's contributions to institutional economics.[4] The remainder of this introduction will provide a brief overview of those aspects of Hamilton's career which provide the material for this study.

The most obvious place to begin an inquiry into the sources of Hamilton's institutional economics would be with

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"Walton Hamilton," International Encyclopedia of the Social Sciences, Vol. 6, pp. 315-316.

[4]. The "institutional economics" that I refer to throughout the distertation is the "old institutional economics," and should not be confused with what has been called the "new institutional economics." The distinctions between the two types of institutional economics are examined by Geoffrey Hodgson, Richard Langlois, Malcolm Rutherford, Anne Mayhew, Viktor Vanberg, and Charles Leathers in Review of Political Economy. Vol. 1, No. 3 (November 1989), pp. 249-380.

the influence of Thorstein Veblen. Veblen is undoubtedly the most renowned individual in the history of institutional economics. The term "institutional economics" has frequently been used by historians of economic thought to describe an intellectual movement which had as its "founding father" Thorstein Veblen [Dorfman 1969; rpt., vol. iv, p. 353]. Clarence Ayres, for example, stated that "the word 'institutionalism' has now been employed for more than a generation to refer to the way of thinking which stems from Veblen..." [Ayres 1952, p. 26]. Similarly, a modern day textbook states: "Thorstein Veblen is the intellectual father of the institutionalists" [Landreth and Colander, 1989, p. 392]. Today the Association for Evolutionary Economics offers an "Institutionalist Prize" for its fledgling scholars and a "Veblen-Commons Award" for its distinguished elders.[5] Recalling that the subtitle of Veblen's most famous book was "An Economic Study of Institutions"[6] it does not seem inappropriate that the name Thorstein Veblen would be inseparably linked to origins of institutional economics.

However, as discussed at greater length in Chapter 2, the initial inspiration for Hamilton's institutional economics appears to have come from a lesser known source

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5. Information on these awards can be found in The Journal of Economic Issues which is the leading journal focusing on institutional economics in the United States.

6. The Theory of the Leisure Class (1899).

than Veblen. In 1910 Hamilton began graduate study at the University of Michigan, obtaining his doctorate in economics in 1913. While at the University of Michigan Hamilton was exposed to the neoclassical economics of Fred M. Taylor, and to the less orthodox thinking of Henry Carter Adams and Charles H. Cooley. Cooley's influence upon Hamilton was especially significant in that Hamilton specifically credited Cooley with teaching him to view society as a complex of institutions that were in an evolutionary process of change. The significance of this source of Hamilton's institutional economics is that Cooley, largely ignored by historians of institutional economics, was in fact a "founding father" of institutional economics.[7]

Further analysis of the sources of Hamilton's institutional economics will address the role of the general intellectual and economic environment of his times. Much of Hamilton's view of the intellectual and economic environment in which he developed his intellectual outlook was inferred in his article on Robert Hoxie [Hamilton 1916]. Hamilton's association with Hoxie began one year after the former received his doctorate in economics. At that time Hamilton was recruited by Hoxie to join the faculty at the University of Chicago. Significantly, Hoxie had been a student and colleague of Veblen, and was said to have been heavily

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[7]. Joseph Dorfman must be credited with having suggested this interpretation. See [Dorfman et al. 1963, p. 41].

influenced by the latter's evolutionary approach to economics.[8]

Hamilton was later brought to Amherst College by Alex Meiklejohn. While Hamilton was on the faculty at Amherst College he wrote several articles that laid the "foundations of his economic theory" [Dorfman in Hamilton 1974, p. 25]. These included "The Institutional Approach to Economic Theory"[9] [Hamilton 1919] which was presented at the annual meeting of the American Economics Association in 1918. According to Joseph Dorfman, this event "marked the formal public launching of Institutional Economics in the United States under that title" [Dorfman in Hamilton 1974, p. 25]. This article is of particular significance to the present study in that it provides an outline of the "characteristics of institutional economics" [Hamilton 1919a, p. 311] as Hamilton saw them in 1918. For this reason "The Institutional Approach to Economic Theory" [ibid.] will be used as the foundation for the analysis of the theoretical

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[8]. Hamilton asserted that among those individuals who had the most influence upon Hoxie, Veblen was the most "persistent influence." "Hoxie knew him when he was formulating his indictment of the taxonomic character of accepted theory...,and pointing the way to the genetic study of institutions" [Hamilton 1916, pp. 857-8] Joseph Dorfman asserted that after Hoxie's death Veblen "was asked about his influence on Hoxie [and] he replied that it was about the same as Hoxie's influence on him" [Dorfman 1972; rpt., p. 354].

[9]. Several of these, including "The Institutional Approach to Economic Theory," were published in Industrial Policy and Institutionalism [Hamilton 1974].

nature of Hamilton's institutional economics found in Chapter 3. Hamilton's presentation and subsequent publication of "The Institutional Approach to Economic Theory" is also of significance in that it was intended to launch a new paradigm of economics in the Kuhnian sense of "universally recognized scientific achievements that for a time provide model problems and solutions to a community of practitioners" [Kuhn 1970, p. viii].

It is clear that Hamilton overestimated the need or desire of economists to unite under the banner of institutional economic theory. Because Hamilton's institutional approach to economic theory never achieved universal acceptance in the discipline of economics it cannot be considered a paradigm in the Kuhnian sense of the term. However, Hamilton did produce a paradigm in the more generic sense of providing a model, pattern, or example of the practice of institutional economics. Chapter 4 will illustrate the paradigmatic nature of Hamilton's institutional economics through an examination of its application to specific economic problems.

Hamilton began addressing specific economic problems using his institutional approach to economics in 1918 when he was appointed to the War Labor Policies Board. Hamilton's experience with war-time economic policy resulted in articles on post-war recovery policy, and a book entitled Readings in the Economics of War [Clark 1918] which he

edited along with John Maurice Clark and Harold Moulton. In 1923, while at Amherst College, Hamilton co-authored The Control of Wages, part of The Workers' Bookshelf series which was produced to meet the "need of the workers for social understanding by a restatement of some of the fundamental problems of modern industrial society..." [Hamilton and May 1968; rpt., n. pag.]. In The Control of Wages Hamilton formulated an alternative to the neoclassical productivity theory of wages based upon his institutional approach to economic theory. Hamilton left Amherst College in 1923 to become Dean of the Robert Brookings Graduate School of Economics and Government and a member of the Institute of Economics.[10] While at the Institute of Economics, Hamilton co-authored two volumes on the problems of the bituminous coal industry in the United States [Hamilton and Wright, 1926 and 1928]. These two volumes, along with the war-time writings, The Control of Wages, and Hamilton's contributions to Prices and Price Policy, [Hamilton, ed., 1938] comprise the largest portion of his writings pertaining directly to the nature of his institutional economics.

In 1928 Hamilton accepted a position on the faculty of the Yale Law School and began focusing his attention on the study of legal institutions. In essence this event marked

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[10]. These two institutions were later merged with the Institute for Government Research to form the Brookings Institution.

the beginning of a new phase of Hamilton's intellectual life which led him away from the discipline of economics.[11] Hamilton's move into the study of law provides some explanation for why he does not have a more prominent place in the history of institutional economics. However, this does not begin to explain why the "Institutional Approach" failed as an attempt by Hamilton to unify heterodox economic theories in order to challenge the preeminance of neoclassical economics.[12] As will be argued in Chapter 5, much of Hamilton's potential influence upon the development of institutional economic theory was dissipated because of the superficial interpretation of Hamilton as a mere disciple of Veblen. Among those who viewed Hamilton's institutional economics as Veblenian economics was Clarence Ayres.

Hamilton can be credited with having played a crucial role in the intellectual development of Clarence Ayres. Ayres, in turn, became one of the leading proponents of institutional economics in the United States. For this reason Chapter 5 will focus in part on Hamilton's influence

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[11]. During the time he taught at Yale Law School Hamilton was admitted to the bar. Following his retirement from Yale Hamilton joined the law firm of Arnold, Fortas & Porter [Dorfman in Hamilton 1974, p. 7]. As discussed further in chapter 5, Hamilton was also distracted from elaborating on his institutional economics by his participation in the Roosevelt administration.

[12]. As discussed in Chapter 3, this was Hamilton's intention.

upon Ayres and the reasons why Ayres writings provide so little reference to Hamilton.

In spite of Hamilton's apparent lack of influence upon institutional economics, there exists in his work a noteworthy contribution that has been largely ignored. Hamilton chose to call his an "Institutional Approach to Economic Theory" because of his belief that institutions were the essential variables which must be studied to arrive at an understanding of the economic system. As Walter C. Neale recently pointed out: "The words institution and institutional are central to institutionalist theory. Not only does the root word give us our name, but also and importantly it and its cognates run through our writings" [Neale 1987, p. 1177]. However, Hamilton contributed more to institutional economics than a name. He also produced a paradigm--if only in the generic sense of a model, pattern, or example--of how to make institutions the subject-matter of economic theory.

# CHAPTER 2

## THE SOURCES OF HAMILTON'S INSTITUTIONAL PARADIGM

### Introduction

While hints of the sources of Hamilton's paradigm[1] of institutional economics appear throughout his writings, Hamilton wrote two articles that discuss the factors which were influential in his own intellectual development. The first is Hamilton's memorial article on Charles Horton Cooley [Hamilton 1929]. Hamilton's memorial article on Cooley shows that Cooley's influence was extensive and particularly important in shaping Hamilton's institutional approach to economic theory. Excerpts of Cooley's writings will be examined in order to elucidate those elements of his approach to socio-economic theory that were incorporated into Hamilton's economic theory.

The second article is "The Development of Hoxie's Economics" [Hamilton 1916]. While that article addressed the influence of the general intellectual and economic environment upon Hoxie, Joseph Dorfman suggested that Hamilton's discussion of the development of Hoxie's

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[1]. I am using the term paradigm in the generic sense of a model, pattern, or example of an institutional approach to economics. As pointed out in chapter 1, Hamilton's institutional approach never gained universal acceptance which disqualifies it as a paradigm in the way Kuhn defines the term [Kuhn 1970, p. viii]. This is discussed further in chapter 3.

economics "might apply in large part to Hamilton himself. For the Hoxie approach, as Hamilton saw it, was also his own approach" [Dorfman in Hamilton 1974, p.16]. Thus Hamilton's account of the development of Hoxie's economics also sheds light on the sources of Hamilton's economics. The article also provides some clues as to why Hamilton's institutional economics was later misinterpreted as being the product of Thorstein Veblen's influence.

## Charles Horton Cooley

Hamilton began his doctoral studies at the University of Michigan in 1910. Important figures during Hamilton's years as a graduate student at the University of Michigan included Charles Horton Cooley, Fred M. Taylor, and Henry Carter Adams who were described as "'the big three'" so far as the graduate students were concerned [Hamilton 1929, p. 184]. However, Hamilton made it clear that it was Cooley who was the instigator of his explorations into alternative approaches to economic theory. "In a division of labor never consciously planned it was Cooley's task to help us toward intellectual freedom" [ibid.]. According to Hamilton, the impact of Cooley's presence was so profound that "whatever we thought or wrote, we thought or wrote differently because of his subtle influence" [ibid., p.

185]. In view of these statements there can be little doubt that Cooley's influence upon Hamilton was significant.

More specifically, Cooley's influence upon Hamilton can be clearly seen in two areas. First, Cooley's perspective on the development of social institutions as an evolutionary and organic process[3] greatly influenced Hamilton's choice of method for his economic inquiries. Second, Cooley's conception of institutions as changeable means through which society controls a significant part of human behavior, made a deep impression upon Hamilton. In the following passage Hamilton illustrated both aspects of Cooley's influence:

> He helped us to see the industrial system, not as an automatic self-regulating mechanism, but as a complex of institutions in process of development. He may never have said so; but from him we eventually learned that business, as well as the state, is a scheme of arrangements, and that our choice is not between regulation and letting

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[3]. Cooley's use of the term "organic process" has much the same meaning as the terms "holistic" and "evolutionary." The term "holism" was, according to Allan Gruchy, coined in 1926 by J. C. Smuts to describe post-Darwinian evolutionary science in which the world is

> an evolving, dynamic whole or synthesis, which is not only greater than the sum of its parts, but which also so relates the parts that their functioning is conditioned by their interrelations [Gruchy 1947, p. 4].

The similarity with Cooley's "organic" view of society can be seen in the following:

> Human life is thus all one growing whole, unified by ceaseless currents of interaction, but at the same time differentiated into those diverse forms of energy which we see as men, factions, tendencies, doctrines, and institutions [Cooley 1966; rpt., p. 4].

The terms "holistic," "evolutionary," and "organic" express the same basic approach to social science. Unless a distinction is called for they will be used interchangeably.

> things alone, but between one scheme of control and another. In some way he forced us to give up our common sense notions, led us away from an atomic individualism, made us see 'life as an organic whole,' and revealed to us 'the individual' and 'society' remaking each other in an endless process of change [ibid., p. 185, emphasis added].

As will become clear in the following chapter on Hamilton's institutional approach to economic theory, the conception of institutions as malleable instruments of social control, the nature of which can be explained only in terms of evolutionary process, and in the context of a social psychology of human behavior, was central to Hamilton's nascent paradigm. An examination of Cooley's social theory will not only corroborate Hamilton's assertion that Cooley was his primary source of inspiration, but will help to illuminate the distinctive characteristics of Hamilton's institutional approach to economics.

Cooley began his academic career by obtaining a doctorate in economics from the University of Michigan, but being unable to confine his interests within the scope of orthodox economic theory, he began branching out into sociology even before he had completed his doctorate.[4] He was encouraged in this venture by H. C. Adams who, according to Cooley, "was sociological in the breadth of his outlook,..." [Cooley 1969; rpt., p. 3]. The result was that

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[4]. Arrangements were made for Cooley's doctoral examination to include questions on sociology "sent on from Columbia by Professor Giddings" [Cooley 1969; rpt., p. 6].

Cooley became the University of Michigan's first sociologist, though he continued to have close ties with both faculty and graduate students in the economics department[5] [ibid., pp. 3-9].

In recounting the main influences upon his thinking Cooley cited Charles Darwin.[6] "From Darwin I got ... the most satisfactory idea of the general process of nature and of the way to study it..." [ibid., p. 4]. The Darwinian concept of the process of evolution led Cooley to conceptualize society as an evolving organism. This notion was further validated through his acquaintance with the philosopher John Dewey. Cooley, as an undergraduate, knew Dewey when the latter was an instructor at the University of Michigan. Later, as a graduate student, Cooley attended lectures that Dewey gave on political philosophy. Regarding this event Cooley wrote:

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[5]. According to Hamilton most of the students making up Cooley's classes in sociology were students of economics. It is not clear whether Cooley was even in a separate department. This is of little consequence, however, because Hamilton gives the distinct impression that graduate study was organized on an extremely informal basis.

> Our majors, if there were such things, were in other fields [than economics]. Cooley's work was with the cubs who had not committed themselves to his trade; it was complementary to the work of Taylor and of Adams [Hamilton 1929, p. 184].

[6]. Cooley also mentions Goethe and Emerson. "[F]or companionship and guidance in my efforts to understand the world of men, I resorted to writers of little system but great wisdom,..." Cooley 1969; rpt., p. 4]

> The chief thing I now recall from his lectures is a criticism of Spencer, in which Dewey maintained that society was an organism in a deeper sense than Spencer had perceived, and that language was its 'sensorium.' I had already arrived at a somewhat similar view [ibid, p. 6].

Cooley also studied the works of William James on psychology during his period of "becoming a social psychologist" [ibid, pp. 8-9]. Thus Cooley was developing his social theory within a methodological framework which would be called evolutionary and pragmatic,[7] the influence of Darwin, and the American pragmatists Dewey and James being apparent. Evolutionary and pragmatic theories of social development provided Cooley with the basis for his critical perspective on neoclassical economics, a perspective that can also be seen in most of Hamilton's writings. It should also be noted that Cooley's approach to social science was rooted in an intellectual environment much the same as that of Thorstein Veblen.[8]

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[7]. In Social Process Cooley described his "tentative method" as involving;

> what is vaguely known to popular thought as the process of evolutionary 'selection,' or the survival of the fittest, and is also described as the method of trial and error, the pragmatic method, the growth of that which 'works' or functions, and by other terms similar to these. Perhaps as simple a description as any is to say that it is a process of experiment which is not necessarily conscious [Cooley 1966;rpt., p. 8].

[8]. The influence of emerging evolutionary social theories, such as that of Spencer, upon Veblen is discussed by Dorfman throughout Thorstein Veblen and His America [Dorfman 1972; rpt.]. It is also revealed in Veblen's early articles. "Why is Economics Not an Evolutionary Science" is

In 1910, his first year of graduate study at the University of Michigan, Hamilton attended a seminar led by Cooley at which the latter presented "Political Economy and Social Process"[9] [Cooley 1969; rpt.]. This paper would have been one of Hamilton's earliest exposures to Cooley and his critical view of orthodox economics. The contents therefore provide a glimpse at an important part of the intellectual environment into which Hamilton entered at the University of Michigan as well as a look at part of Cooley's social theory.

Hamilton quoted from the following passage in his article on Cooley [Hamilton 1929, p. 185]:

> I may say that the economic theorist appears like a man who should observe only the second hand of a watch: he counts the seconds with care, but is hardly in a position to tell what time it is [Cooley 1969; rpt., p. 252].

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only the most obvious example. See The Place of Science in Modern Civilization [Veblen 1990; rpt., pp. 1-179]. The similar approaches of Cooley and Veblen, along with the fact that Cooley wrote little that applied directly to economics, helps to explain why Hamilton's institutional economics is often attributed to the influence of Veblen, and why Hamilton has been viewed as a disciple of Veblen's. This is taken up further below and in Chapter 5.

[9]. In his article on Cooley, Hamilton quoted from a paper "written for our seminar, which later we persuaded [Cooley] to print" [Hamilton 1929, p. 185]. Though Hamilton does not provide a citation, the passage can be found in "Political Economy and Social Process" [Cooley 1969; rpt., p. 251]. A footnote to the article confirms that this is the paper to which Hamilton was referring: "This paper was read before a small group of students and instructors in 1910.... their partiality,... has suggested that it be printed" [ibid.].

This particular statement points out Cooley's belief that the scope and method of economics had led economists to ignore the larger social process in which market mechanisms play merely a part.

The neoclassical conception of demand was one example used by Cooley to illustrate his charge that the scope and method of inquiry in political economy was inadequate:

> What is demand? It is simply an expression of economic power and will as determined by all the existing conditions. It is as much the effect as the cause of the actual state of the economic system. Like all our inheritance it comes down from the past in a turbid stream, bearing with it those struggles and compromises that make up human history. All the evils of the economic system, except those which are added in the market process, are already implicit in demand, and of course are transmitted to production and distribution. To accept this stream as pure is as if a city should draw its drinking water from a polluted river and expect to avoid typhoid by using clean pipes. The pipes--that is, the process connecting demand and supply--are a matter of great solicitude to the economist, the source comparatively little [ibid., p. 253].

Cooley was taking issue with the assumption that markets, and the outcomes they produce, can be analyzed as ethically neutral facts. This argument stemmed from differences in method inasmuch as static neoclassical economic models abstracted from the evolutionary social process that was central to Cooley's perspective on social theory. From Cooley's perspective it appeared evident that market demand would reflect "[a]ll the evils" [ibid.] that society had inherited from the past. Hence, while the deductive logic used in the neoclassical analysis of demand may appear value

free--the "clean pipes" [ibid.] of Cooley's metaphorical example--accepting the results of market processes as ethically neutral is to make a tacit value judgement. That judgement was that the social problems inherited from the past do not matter; the "polluted water" [ibid.] of demand can be assumed to be pure because it is delivered through "clean pipes." Economists thereby excused themselves from addressing ethical issues that, as will become evident, Cooley believed were the responsibility of social scientists.

In order for economists to adequately address social problems, Cooley argued that the conventional view of public control had to be rejected.

> My impression is that economists treat [public control] as a matter distinct from the economic process, as a patch which may or may not have to be added at a given place, but which is, in any case, something of an external and alien nature. I question whether we shall understand these matters until we attain a view which shall see public control as a normal and inseparable part of the economic process itself.... Have not economists made abstraction of certain phases of public control to which they were accustomed, such as the existing laws of property, contract and bequest, accepting these as normal while regarding others as exceptional, as more or less justifiable 'interference'? But is it not the fact that there is here a continuous socio-political process which cannot be understood except as a whole and that the delimitation I have just mentioned is merely arbitrary? [ibid., p. 257].

This passage begins to illustrate Cooley's conception of the economy as an evolving "organism" made up of interrelated institutions which exert control over economic behavior. In

this view institutions are the result of an ongoing social process as opposed to being the result of some preordained social or economic laws. Hence, institutional arrangements cannot be assumed to be normal or abnormal based on arbitrary criteria such as whether they are public or private.

The bias on the part of neoclassical economists to denigrate instruments of public control as abnormal, seemed to Cooley to be the result of an emphasis on individual rationality and the denial of collective rationality [ibid., pp. 257-8].

> Political economy not only recognizes but exaggerates individual rationality, assuming an almost ideal efficiency in it, while at the same time the correlative phenomenon of collective rationality is left out in the cold [ibid., pp. 257-258].

Cooley further argued that the emphasis on individual rationality was the result of a belief on the part of neoclassical economists that there can be no collective agreement on the values which society should pursue. "There is a disposition to set them aside as matters of sentiment rather than of the intellect,..." [ibid., p. 258]. Cooley rejected this predilection, arguing that the ethical aims of society present "an intellectual problem, that of the principles in following which we may achieve the ends that all desire" [ibid., p. 258]. Hence,

> A social science which is not also, in its central principles, an ethical science is unfaithful to

> its deepest responsibility, that of functioning in aid of general progress [ibid.].

Cooley therefore rejected the now commonplace economic principle that economics is a positive science, and that the economist is not required, nor even expected, to engage normative issues.

Cooley ended this paper by asking whether;

> political economy is not, for the most part, pre-Darwinian. Is not the tradition originally formed under the influence of an individualistic, non-evolutionary philosophy still, in the main, ascendent, modified only by somewhat superficial applications of doctrinal patchwork? [ibid., p. 259].

This question suggests that Cooley's methodological concerns with neoclassical economic theory were quite similar to those of Veblen when he asked "Why is Economics Not an Evolutionary Science?" [Veblen 1990; rpt., pp. 56-81]. This apparent similarity between Cooley's evolutionary approach to social theory in general and his critique of economics in particular, and that of Veblen's, helps to explain why Hamilton would later find himself allied with economists like Robert Hoxie, who, as an admiring student and colleague of Veblen, also rejected the mechanistic approach of neoclassical economics. Cooley, like Veblen, was a pioneer in an emerging intellectual movement which rejected mechanistic models of economic phenomena while embracing an evolutionary approach; a point which I will take up further below.

While "Political Economy and Social Process" was likely Hamilton's first exposure to Cooley's critical views on economic theory, Cooley's concern with social institutions as important elements in the study of economics had, according to Hamilton, become evident with the publication of an article entitled "Personal Competition," in 1899 [Hamilton 1929, p. 185]. In that article Cooley does discuss "institutions" and "means of control," though he does not use these terms consistently throughout [Cooley 1969; rpt., pp. 171-3, 186-7]. However, by 1909, a year before Hamilton arrived at the University of Michigan, Cooley published Social Organization [Cooley 1956; rpt.]. In that work the importance of institutions, for Cooley, is more clearly revealed as chapters 18 and 19 were devoted to "Institutions and the Individual."

Cooley described institutions generally by stating that "In the individual the institution exists as a habit of mind and of action..."[10] [ibid., p. 314]. Moreover, institutions were viewed by Cooley as parts of society taken as a whole, and did not have a life apart from the individual.

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[10]. This sounds very much like Veblen's statement in The Theory of the Leisure Class that institutions are "prevalent habits of thought...." [Veblen 1953; rpt., p. 132] It may be useful to note that Cooley cites Veblen's Theory of the Leisure Class, but not in either of the chapters being discussed, and not in regard to the concept of institutions. See [Cooley 1956; rpt., p. 119]

> The individual is always cause as well as effect of the institution: he receives the impress of the state whose traditions have enveloped him from childhood, but at the same time impresses his own character, formed by other forces as well as this, upon the state, which thus in him and others like him undergoes change [ibid.].

From this statement it would appear that Cooley did not conceive of the social organism as an entity that is impervious to the initiatives of individuals, but as a collection of individuals who, while largely influenced by their cultural environment, also help to remake that environment in an evolutionary process of change and adaptation.[11]

> The mechanical working of tradition and convention pours into the mind the tried wisdom of the race, a system of thought every part of which has survived because it was, in some sense, the fittest, because it approved itself to the human spirit [ibid., p. 320].

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[11]. According to Malcolm Rutherford,

> The old institutionalism professes a holistic method which tends to concentrate attention on the socialized nature of man,... If this view is taken too far, as it often is within the Veblen/Ayres tradition,... there is a tendency to see institutional change as an outcome of a process involving virtually autonomous social forces (institutions versus technology) that impinge on individuals [Rutherford 1989, pp. 313-314, emphasis added].

It is important to note that Cooley (and Hamilton) did not adhere to a holism wherein individuals cannot affect change in institutions. This distinction between the "Veblen/Ayres tradition," and what I will call the Cooley-Hamilton model of institutional economics, will help to explain why Hamilton viewed institutions as potential instruments of progressive social change, while later institutionalists, Ayres in particular, would largely ignore this aspect of Hamilton's approach to economic theory. See Chapter 5.

Thus, while institutions were conceived by Cooley to be a "comparatively rigid part of the social structure," [ibid., p. 319] they are at the same time subject to alteration in that "moral progress always begins in a revolt against institutions" [ibid., p. 320].

During Hamilton's time at the University of Michigan, Cooley was working on his book entitled Social Process. According to Hamilton, "[Cooley] shared with us the progress of his creative labors; from very faint beginnings we watched the work take shape at his hands" [Hamilton 1929, p. 185]. In the chapters on "Valuation as a Social Process" and "The Institutional Character of Pecuniary Valuation," [Cooley 1966; rpt., chapters 25 and 26] Cooley elaborated on his view of the institutional and evolutionary nature of economic behavior.

For example, Cooley argued that values are derived from both an innate human nature and the institutional environment within which the individual acts as a social being.

> As regards the forms of human life to which values are to be referred, it seems to me of primary importance to make a distinction which I will call that between human-nature values and institutional values [ibid., p. 285].

By "human nature values" Cooley meant values that are common to all human beings in as much as "the organism from which they spring is much the same" [ibid.]. However, the

realization of these basic needs is conditioned by the institutional environment.

> In moral values, for example, there are some, like those of loyalty, kindness, and courage, which spring quite directly from human-nature; others, like the obligation to go to church on Sunday, are evidently institutional [ibid., p. 287].

Importantly, Cooley asserted that pecuniary values were the result of culturally specific institutions, and not a product of a hedonistic calculus inherent in human nature.

> It is apparent that the values of the pecuniary market fall under the latter head [of institutional values]. Their immediate source is a social mechanism, whatever their indirect relation to human nature may be. You do not find them wherever man is found, but only where there is a somewhat developed system of exchange, a commodity recognized as money, and an active market [ibid., p. 294-5].

Pecuniary values, according to Cooley, may spring from the needs of innate human nature, but assume their form as a result of the influence of institutions. For example, the specific items which satisfy our basic needs for food, clothing, and shelter are as much a product of culturally specific institutions as they are of innate human nature [ibid., p. 295]. This conception of human nature values and pecuniary values led Cooley to assert that "[t]he study of value-making institutions becomes ... <u>the</u> principal means of arriving at practical truth" [ibid., p. 296, emphasis added]. The importance of this aspect of Cooley's thinking, as it relates to Cooley's influence upon Hamilton, becomes strikingly evident when it is compared to Hamilton's five

tests of economic theory.[12] It is most obvious in Hamilton's dictum that the "proper subject-matter of economic theory is institutions" [Hamilton 1919, p. 313].

The question may be raised as to whether Cooley's explorations into an evolutionary approach to economic theory was an independent effort, or was in part the result of the influence of Veblen's early works. If the latter is true then Hamilton's institutional economics would be, as many institutional economists have asserted, the product of Veblen's influence.[13] However, while it cannot be definitively established that both Cooley and Veblen were working independently along similar lines in the early 1890s the dates of their respective publications suggest that this may be the case. Cooley's "Personal Competition" published in 1899, which Hamilton described as being about an institution [Hamilton 1929, p.185], evolved out of an earlier paper entitled "Competition and Organization" published in 1894 [Cooley 1969; rpt., p. 163n]. Veblen's published writings on economic institutions may be said to have begun as early as 1892 with the appearance of "Some

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[12]. See chapter 3.

[13]. For example, according to Ayres: "the word 'institutionalism' has now been employed for more than a generation to refer to the way of thinking which stems from Veblen..." [Ayres 1952, p. 26].

Neglected Points in the Theory of Socialism"[14] [Veblen 1990; rpt., pp. 387-408]. As both Cooley and Veblen were products of the intellectual environment of their times it is not unreasonable to believe that both independently arrived at the conclusion that evolutionary methods were a useful alternative to the mechanistic approach of neoclassical economic theory, that institutions were an important aspect of social evolution, and that institutions were an important subject for economic inquiry. As Nicholas Timasheff put it: "as was natural for a person whose views took shape in the last quarter of the nineteenth century, Cooley was an evolutionist of a kind" [Timasheff 1967, p. 149]. As discussed below, Hamilton was also of the opinion that the intellectual environment of the late nineteenth century had engendered a number of "protestants" interested in institutions and evolutionary methods.

More importantly, if we take Hamilton's own remarks concerning Cooley's influence at face value, it was Cooley, and not Veblen, who would seem to have had the earliest and deepest influence upon Hamilton, having introduced the latter to an evolutionist's critique of orthodox economics in graduate school. Moreover, as will be discussed further

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[14]. It is of some interest that this article is in part a critique of some assertions made by Spencer. Veblen, however, wrote that "[t]he paper is mainly a suggestion, offered in the spirit of the disciple,..." [ibid, p. 387]. As mentioned above, Cooley was also both influenced by, and critical of, Spencer.

in Chapter 5, the notion that institutions were instruments of social control that could be consciously altered for the purpose of controlling the course of economic development, was a distinguishing feature of Hamilton's institutional economics that could not have originated from the influence of Veblen.[15] It is therefore my contention that Charles Horton Cooley was in fact the "fourth founding father of institutional theory" [Dorfman 1963, p. 41], having been the primary source of Hamilton's institutional economics.

## The General Intellectual and Economic Environment

While it is clear that Cooley played an important role in Hamilton's intellectual development, his institutional economics developed within an intellectual and economic environment that had fostered "a number of dissenting schools" of economics [Hamilton 1916, p. 857]. Hamilton referred to these dissidents generally as "protestants" [ibid.]. In "The Development of Hoxie's Economics" [ibid.] Hamilton describes the intellectual development of one of these "protestants." The article is of particular interest in regard to the sources of Hamilton's economics because it

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[15]. Dorfman also credits Cooley with having "left a profound impress upon... J.M. Clark" [Dorfman 1963, p. 41]. As discussed further in Chapter 5, Hamilton has been mistakenly interpreted as a disciple of Veblen's, while Clark, his colleague and collaborator, was grouped with those "more concerned with immediate economic and social issues than was Veblen" [Gruchy 1947, p. 2].

has been suggested by Joseph Dorfman that Hamilton was also describing the development of his own approach to economics while in the process of elucidating Hoxie's [Dorfman in Hamilton 1974, p. 16].

According to Joseph Dorfman it was Robert Hoxie who was primarily responsible for bringing Hamilton to the University of Chicago, his first academic position following graduate school at the University of Michigan [ibid., p.6]. Hoxie was not only Hamilton's sponsor but an evolutionary economist who, according to Hamilton, "accepted the general theory of 'social process'[16] and called himself an institutional economist"[17] [Hamilton 1916, p. 863n]. Thus it is evident that Hoxie and Hamilton had a shared interest in evolutionary methods and institutional analysis.

As had been the case with Hamilton, Hoxie had a mentor who was referred to by Hamilton as one of the "protestants" -- those intellectuals who would "attack the preconceptions of the science and insist upon the institutional and evolutionary character of its phenomena" [ibid., p. 857]. Where Cooley had served as Hamilton's

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[16]. The reference was probably to Cooley's Social Process.

[17]. Strictly speaking, Hoxie did not call himself an institutional economist in the article Hamilton cites. Hoxie did mention "social process--action and institution" regarding the subject matter of the social sciences [Hoxie 1907, p. 746]. It is, therefore, likely that Hamilton was the first to use the term "institutional economist" in print.

protestant role model, it was Thorstein Veblen who inspired Hoxie to look beyond the scope and method of neoclassical economic theory. Hamilton claimed that, among the individuals who influenced Hoxie, Veblen's was "the most persistent influence" [ibid.].

> Hoxie knew him when he was formulating his indictment of the taxonomic character of accepted theory, protesting against its neglect of the salient aspects of industrial life, and pointing a way to the genetic study of institutions. Hoxie saw him in the process of revealing the importance of the technical and the pecuniary aspects of social life, coining terms in which others could voice with unction their criticisms of the economics of the schools, and formulating principles that could be incorporated into the methodology of the 'coming' economics [ibid., p. 857-8].

The importance of Hoxie's knowledge of Veblen's economics is difficult to assess with respect to how it may have influenced Hamilton. Because Hamilton had no publications at the time of his arrival at the University of Chicago, there is no evidence concerning his familiarity with Veblen's writings at that time. However, had he not already been familiar with Veblen's work, Hamilton must have become familiar with it through his contact with Hoxie. In 1915, two years after completing his doctoral studies at Michigan, and at the time he worked at the University of Chicago, Hamilton published an edited volume entitled Current Economic Problems [Hamilton, ed., 1915]. Among the long list of contributors was Thorstein Veblen [ibid., pp. xii and xxiv]. Clearly, by 1915, Hamilton had become

acquainted with the work of Veblen and found it to be a contribution to the study of economic problems. However, it is important to point out that Hamilton's discussion of Veblen's "persistent influence" was directed specifically to Hoxie, and not himself. To the extent that Hamilton's remarks have been interpreted as applying to himself as well as Hoxie, Hamilton may have inadvertently fostered the notion that he was a disciple of Veblen.[18] For example, although Hamilton pointed out similarities in method between Cooley and Hoxie [Hamilton 1916, p. 871fn], he specifically referred to Veblen's Theory of Business Enterprise as an example of "institutional studies" that Hoxie, the "institutional economist," would have accepted as part of economics [ibid., p. 863fn]. Thus, while Hamilton's remarks were made specifically for the purpose of elucidating Veblen's influence upon Hoxie, Hamilton contributed to the now commonplace association of "institutional economics" with Veblen.

In his account of the development of Hoxie's economics Hamilton also discussed the importance of the "intellectual" and "material environment" so far as it helped to foster a

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[18]. Although Dorfman suggested that Hamilton's remarks concerning Hoxie may have applied to Hamilton [Dorfman in Hamilton 1974, p. 16], he was not implying that Hamilton was a disciple of Veblen. The view of Hamilton as a disciple of Veblen can be found in [Gruchy 1947, p. 2]. The issue is addressed further in Chapter 5.

generation of economic "protestants."[19] As Hamilton stated:

> The discovery of environment was at last made; and, as a consequence, we developed an extenuating disposition to place the blame upon society, institutions, or even more vaguely 'the system.' With this discovery the natural world of laws began to give way to a social universe, filled with 'arrangements' capable of being manipulated. And, as attention was diverted from the mechanical things of life, the idea of evolution was gradually accepted and particular acts and institutions began to be conceived of as inseparable parts of a closely connected whole. So it came about that explanations which had their ultimate source in a mechanical and individualistic natural system failed to satisfy the increasing number who were finding it difficult to accept such a fundamental hypothesis [Hamilton 1916, p. 859].

This statement illustrates Hamilton's perception of how the growing awareness of evolutionary theory, and the appreciation for the importance of changing institutions, had influenced the "protestants," including Hoxie and himself, by providing an alternative to the mechanistic and individualistic approach of neoclassical economics. Hamilton's perception that the general intellectual environment was shifting towards evolutionary theories of society appears to have played a role not only in the development of his own theoretical approach to economics, but in his belief that the number of "protestants" that were

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[19]. The fact that Hamilton's description of the effect of the general intellectual and material environments is written in the first person plural lends some support to Dorfman's contention that Hamilton's remarks about the development of Hoxie's economics could apply to Hamilton as well. See [Hamilton 1916, pp. 858-859].

emerging in the economics profession was approaching a size sufficient to enable the launching of a successful challenge to the dominant paradigm of neoclassical economics.[20] As discussed further below and in chapter 3, this group of "protestants," was the principal group that Hamilton hoped to unite under the banner of institutional economics.[21]

Hamilton also recognized the changing "material environment," [ibid.] especially the emergence of large scale industry, as an important impetus to economists who questioned the validity of the mechanistic neoclassical theory.

> The uncertainty which we have just detected alike in economic theory and in intellectual attitude was in large measure a result of the accelerated development of the industrial system.... A continent, possessed of unparalleled resources, had just been subjugated by the aid of the machine process. An aggregation of trades, processes, and markets was being forged into an industrial system. Through a network of institutions, themselves in process of being created, these were coming to be a delicately balanced pecuniary system.... The adjective 'normal' seemed strangely inappropriate when applied to any aspect of the situation; in the perpetual newness of

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[20] Elsewhere Hamilton stated that:
since control sets the problem, welfare fixes the end, institutions are the changeable factors through which control must be exercised, and the whole is an affair of development which must be dealt with genetically, there seems no reason why eventually these groups of protestants may not join in a common enterprise [Hamilton 1918b, pp. 404-5].

[21]. As I argue in chapter 3, this was the purpose and significance of "The Institutional Approach to Economic Theory" [Hamilton 1919a].

> things all must be 'natural' or all unnatural. Nor could the situation be expressed in static terms. It offered no disposition to return to an 'equilibrium' after a 'disturbing force' had disarranged the gear.... First, static theory, and later the quantitative 'dynamics' which was added to it, seemed foreign to the contemporary America of perpetual transition [ibid., pp. 859-860].

To Hamilton the history of economic development served to illustrate that economic institutions did in fact evolve as society adapted to a world of changing technology. From this it followed that no particular set of arrangements or institutions could be sacrosanct. In particular, the price system was portrayed by Hamilton as only one of a number of interconnected and evolving institutions which could produce a variety of outcomes, both good or bad, depending upon its nature and function.[22] Thus for Hamilton and other "protestants," the mechanics of price determination, being an abstraction from historically relative institutional realities, were of little help in explaining the actual nature and function of the economic system.

In short, according to Hamilton, the intellectual and material environment of the late nineteenth and early twentieth century helped to foster a number of "protestants," who would promote an evolutionary approach to

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[22]. As Hamilton later stated:
Competition, property, the price structure, the wage system, and like institutions refuse to retain a definite content. Not only are things happening to them, but changes are going on within them [Hamilton 1919a, p. 315].

economic theory. In the "protestant" view, institutions were a key element in explaining human behavior and social change. Both Cooley and Veblen, as products of the changing intellectual and economic environment of the late nineteenth century were, in turn, important influences upon Hamilton and Hoxie respectively.

# CHAPTER 3

## HAMILTON'S INSTITUTIONAL APPROACH TO ECONOMIC THEORY

### Introduction

This chapter begins the examination of the nature of Hamilton's institutional economics with an analysis of his approach to economic theory. The analysis is organized around the contents of "The Institutional Approach to Economic Theory" [Hamilton 1919a]. There are three reasons for using this article by Hamilton as a framework for the present inquiry.

First, "The Institutional Approach to Economic Theory" was Hamilton's most succinct and complete statement of his beliefs about the appropriate scope and method of economic theory. The article described the "Characteristics of Institutional Economics" in the form of "five tests which any body of doctrine which aspires to the name of economic theory must be able to meet"[1] [ibid., p. 311]. In this way Hamilton gave both an "outline of the case for institutional theory" [ibid., p. 317], and his reasons for denying that neoclassical economics had a legitimate "claim to the dignity of 'economic theory'" [ibid., p. 310]. The article thereby provides a framework with which to organize

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[1]. Each "characteristic" or "test" of economic theory will be discussed below.

Hamilton's scattered efforts to reproach neoclassical economic theory and formulate an alternative approach.[2]

Second, publication of "The Institutional Approach to Economic Theory" concluded the period from 1915 to 1918 during which Hamilton had laid the "foundations of his economic theory" [Dorfman in Hamilton 1974, p. 25]. Beginning with his appointment to the War Labor Policies Board in 1918, Hamilton's attention began to shift toward practical economic problems such as the demobilization of labor following World War I, the control of wage rates, the troubled bituminous coal industry, and price policies.[3] "The Institutional Approach to Economic Theory," can, therefore, be interpreted as the capstone work in Hamilton's period of formulating his theoretical approach in the abstract. The period during which Hamilton put his institutional economics into practice addressing practical

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[2]. Several of Hamilton's articles, including five articles originally published in The Journal of Political Economy [1915-1918], and "The Institutional Approach to Economic Theory," originally published in The American Economic Review [1919], were collected in a volume entitled Industrial Policy and Institutionalism [Hamilton 1974]. Of these articles only "The Institutional Approach to Economic Theory" was written expressly for the purpose of defining institutional economics.

[3]. The titles of Hamilton's books illustrate this point. As examples there are: The Control of Wages [1923], The Case of Bituminous Coal [1926], A Way of Order for Bituminous Coal [1929], Prices and Price Policies [1938].

economic problems will be addressed in the following chapter.[4]

Third, "The Institutional Approach to Economic Theory" is of special significance because it "marked the formal public launching of Institutional Economics in the United States under that title" [Dorfman in Hamilton 1974, p. 25]. Institutional Economics was intended by Hamilton to be a new theoretical paradigm in the Kuhnian sense of "universally recognized scientific achievements that for a time provide model problems and solutions to a community of practitioners" [Kuhn 1970, p. viii]. Neoclassical economic theory, according to Hamilton, failed all of his "five tests" of economic theory, while institutional economics was portrayed as the only theoretical approach capable of passing the five tests.[5] Hamilton's thesis was simply that "'institutional economics' is 'economic theory'" [ibid., p. 309]. As will be shown below and in the following chapter, Hamilton had "model problems and solutions" [Kuhn 1970,

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[4]. Because Hamilton believed that the primary purpose of economic theory was to address real-world economic problems, rather than theoretical abstractions, the division of Hamilton's work between 'theory' and 'practice' is one of emphasis and convenience. As will be discussed further, from Hamilton's perspective, both activities involve the formulation of economic theories. Hence, the division of Hamilton's work between two periods, and two chapters should not mislead the reader; both chapters 3 and 4 address the nature of Hamilton's economic theory.

[5]. This was not surprising given that the "five tests" of economic theory corresponded directly to the "Characteristics of Institutional Economics" [Hamilton 1919, p. 311]. One could say that the examination was rigged.

viii] in mind that he believed could only be adequately addressed with his institutional approach. These were typically theoretical approaches to practical problems, in contrast to abstract problems requiring theoretical solutions. Hamilton's goal was, according to Joseph Dorfman, to advance "economics as an instrument of social progress" [Dorfman in Hamilton 1974, p. 5]. Toward that end Hamilton made relevance to a practical problem one of his tests of the adequacy of economic theory.[6] Hence, the majority of Hamilton's writings addressed practical economic problems rather than purely theoretical economics.[7]

Before proceeding, a brief explanation may be in order as to the manner in which "holistic"[8] concepts are defined. Ingve Ramstad has cited Hamilton's article on "Institutions" [Hamilton 1932] as an example of a holistic definition [Ramstad 1986, p. 1084]. The following passage quoted by Ramstad helps to explain the nature of holistic definitions:

> Holistic definitions are likely to be long, complex and open-ended. The definitions of concepts as institution, function, folk-society, or role will take a chapter or a long article and will really be essays in theory. Such concepts

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6. This is discussed below under "The Problem of Control."

7. This explains why the following chapter contains a disproportionate share of the analysis concerning the nature of Hamilton's institutional economics.

8. The term "holism" had not yet been coined in 1918 when Hamilton wrote "The Institutional Approach to Economic Theory." Terms such as "organic" and "genetic" were used by Hamilton in much the same manner as holistic.

> may have a vague core meaning, but the core shades off rapidly into a series of variants, circumstances, aspects, standpoints, and relations or contrasts with other concepts. And no such "definitions" will pretend to be complete; there is always more to be said and discovered [Diesing 1971, p. 211].

Hamilton's style of exposition was holistic in that his definitions of fundamental concepts are contained in their relations and contrasts to other concepts. Hence, the analysis of his work may appear initially to provide somewhat incomplete and vague explanations of particular concepts, while becoming repetitious as the process continues. This is because none of the key concepts of Hamilton's "characteristics of institutional economics" (e.g. institutions) were given formal and concise definitions; their meaning and significance cannot be fully understood until their relations to all the other elements of the entire conceptual framework becomes clear. Hamilton believed that, "[t]hought cannot be pent up within rigid verbal symbols..." [Hamilton 1938, p. viii], and he made little effort to do so.

## Unifying Economic Science

Hamilton's first of five tests for economic theory was that:

> Economic theory should unify economic science. The task of a general body of theory in any subject is to give unity to its investigations. [Hamilton 1919a, p. 312].

Neoclassical value theory failed this test, according to Hamilton, on the grounds that its scope and method did not apply to all of economic science. In terms of the scope of neoclassical economic theory, it limited "its concern to very particular questions" [Hamilton 1918b, p. 219] such as the origin of value. However, this was too narrow a focus in Hamilton's view. Questions of value could not compass all of economic science with its

> sprawling frontiers [that] reach from value theory across money, taxation, transportation,... salesmanship, insurance and advertising.... Each of these subjects has its own point of attack, its own method, and its own personnel. Those who seek truth in these remote fields of inquiry know little and care less for value theory [Hamilton 1919a, p. 312].

In terms of method, Hamilton pointed to the extensive use of deduction in neoclassical value theory. This made it a "logical rather than a historical inquiry," in contrast to the "practical subjects" that were "subject to descriptive treatment" [Hamilton 1918b, p. 219].[9] Hence, descriptive inquiries had to have scientific status in order to bring

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[9]. Hamilton's argument that the applied fields of "economic science" were not being unified by neoclassical economics is subject to criticism on the grounds that neoclassical methods had already found their way into the applied fields. However, what Hamilton was arguing against was the tendency to view the methods of value theory as the only legitimate approach to economic inquiry, thus giving an inferior status to applied work done by "protestants" [Hamilton 1918c, pp. 386-389, 405]. Hamilton had in mind the work of "protestants" like Cooley, who had written on "The Theory of Transportation" [Cooley 1969; rpt., pp. 17-118], and Harold Moulton who wrote on money and banking [Moulton 1916].

the "practical subjects" within the realm of economic theory. Hamilton argued that claim of neoclassical value theory to the title of 'economic theory' implied that subjects that did not pertain specifically to pecuniary value, and did not utilize deductive methods, were precluded from attaining the status of economic theory [Hamilton 1818b, p. 218-19]. Hamilton rejected this alleged view stating: "In its last analysis 'theory' is only generalized description"[10] [Hamilton 1918b, p. 218n].

The use of generalized description as a method for economic research was, for Hamilton, the key to unifying economic science through his institutional approach. In Hamilton's view, the "genetic" method (discussed below) was a historical and evolutionary method of inquiry that lent itself to descriptive treatment more than deductive logic. Evolving institutions were the subject matter for Hamilton's genetic method. Because institutional arrangements evolve they are viewed as historically relative phenomena, and not

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[10]. Although Hamilton did not provide a formal definition of "generalized description," he did describe its use for "theory in the accepted sense" [Hamilton 1918b, p. 228]. This was given in his discussion of Adam Smith's Wealth of Nations.

> [I]n its execution in detail it abounds in historical incident and contemporary fact. The systematic way in which conclusions on minor points are gathered into larger generalizations and the whole is organized into a single coherent discussion of a problem of vital social significance leaves no doubt as to its character [ibid.].

postulated as if they were eternal verities. Therefore, institutions must be described in order to be analyzed.

According to Hamilton, "'[i]nstitutional economics' alone meets the demand for a generalized description of the economic order" [Hamilton 1919a, p. 311]. The source of this "demand" was the Committee on Cooperation in Economic Reserarch appointed by Irving Fisher, the president of the American Economics Association (AEA) in 1918. Hamilton and Harold Moulton were primarily responsible for preparing the Committee's report that stated:

> Our knowledge of economic agencies, institutions and activities is very inadequate, and lack of knowledge of the things to be controlled is the greatest obstacle to an effective program. Problems germane to the war [World War I] and the peace to follow touch the most fundamental institutions of society, cover the widest range of subjects, and appeal to the greatest diversity of talent.[11]

Thus, the "demand for a generalized description of the economic order" [ibid.] came largely from Hamilton and other "advanced, liberal economists" who were sympathetic to a "reconstruction of economics" [Dorfman in Hamilton 1974, pp.25-26]. As discussed below, World War I provided an additional impetus to this movement.

Hamilton's contention that neoclassical value theory was unable to unify economic science, and that institutional economics would accomplish this function, serves to

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[11]. Quotation is from Dorfman in [Hamilton 1974, pp. 26-7].

illustrate Hamilton's intention to launch a new theoretical paradigm in the Kuhnian sense of a universally accepted approach to a scientific discipline [Kuhn 1970, p. viii]. Hamilton claimed to "discern various groups who assert that they are concerned with the problem of control, the theory of welfare, the nature of institutions, and the application of the genetic method,..."[12] [Hamilton 1918c, pp. 404-405]. According to Hamilton, there was "no reason why eventually these groups of protestants may not join in a common enterprise" [ibid., p. 405]. Although in the "Institutional Approach" Hamilton mentioned only applied fields of "economic science" as not being unified by neoclassical economics, it is likely that Hamilton included them among the "protestants."[13] The significance of this becomes clear when it is understood that Hamilton was a key figure in a movement towards "permanent reclamation of the American Economic Association" by heterodox economists.[14] As Hamilton had stated:

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[12]. Hamilton did not name these "various groups" directly. Whether "H.C. Adams, Cooley, Veblen, and Mitchell" [Hamilton 1919a, p. 318] made up a single group is not clear. Hamilton suggests that the "English 'welfare school,' particularly Webb, Hobson, Cannan, Tawney and Clay" might have been counted as a group of "protestants" inasmuch as they shared a "common departure from neo-classical analysis" [ibid.].

[13]. See footnote 9.

[14]. The quatation is from a letter to Hamilton from Harold Moulton dated May 31, 1918 [Dorfman in Hamilton 1974, p. 27]

> [I]t may be that the several groups of workers affected do not appreciate their mutual opposition to the dominance of value theory; it may be that it is impossible for them to pool their contributions into a new economic theory which can give an organic interest to the larger field. But fortunately there is evidence that they are mere aspects of a single general intellectual movement [Hamilton 1918c, p. 404].

Clearly Hamilton had envisioned an opportunity to overthrow neoclassical value theory as the dominant paradigm in economics by unifying the "several groups of workers" who were opposed to value theory into "a single general intellectual movement." Hamilton's presentation of "The Institutional Approach to Economic Theory" [1919] at the December 1918 meeting of the American Economics Association, can be interpreted as part of that effort.[15]

## The Problem of Control

Hamilton's second test for economic theory was that it "should be relevant to the modern problem of control" [ibid., p. 312]. In Hamilton's interpretation, making theory relevant to a practical economic problem was an accepted characteristic of general economic theory, as

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[15]. At the same session during which Hamilton presented the "Institutional Approach," J. M. Clark presented "Economic Theory in an Era of Readjustment" [Clark 1919]. The fact that Clark and Hamilton were, in a sense, "co-conspirators" will be of some signficance in Chapter 5.

distinct from "value theory."[16] Moreover, "[s]uch relevancy has always marked economics in the periods of its most fruitful development" [ibid.].[17] Therefore, focusing institutional economics upon a current economic problem was, to Hamilton, a departure only from neoclassical value theory, not from economic theory in the broader and more traditional sense. Furthermore, it was "quite in keeping with its scientific character [for economists to] impartially gather the facts and formulate the principles necessary to an intelligent handling of such problems" [Hamilton 1919a, p. 312]. In other words, economic research aimed at specific economic problems, while having normative

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[16]. Hamilton would use "'economics'," "'economic science'," or "'economic theory'" in quotation marks to mean conventional neoclassical "'value theory'" or "'value economics'." Hamilton used "'political economy'," "'social ethics'," "social politics'," "'economic art'," and "'general economics'" to describe economic theory that ranged beyond the scope and method of neoclassical value theory. Hamilton saw no single term that adequately described the whole of economic science. This undoubtedly contributed to Hamilton's perception of the need for a new title of "institutional economics" to unify economic science. See [Hamilton 1918b, pp. 229-237, 243-244, Hamilton 1918c, p. 389, and Hamilton 1916, pp. 565-566].

[17]. Hamilton wrote approvingly of Adam Smith's making the subject of The Wealth of Nations "a practical problem of current importance rather than a prescribed academic subject" [Hamilton 1918b, p. 230]. Likewise, Hobson's Work and Wealth was praised by Hamilton for focusing on "the solution to complex social problems" [Hamilton 1916, p. 566]. In contrast, Hamilton criticized Mill for using a "logical concept" in place of "a current problem" to organize Principles of Political Economy. "Quite inevitable the category of wealth which [Mill] chose robbed the volume of the organic unity which a problem would have imparted and left a mechanical entity in its place" [Hamilton 1918c, p. 241].

concerns, need not have an inherent bias according to Hamilton.[18]

For institutional economic theory, Hamilton saw the "comprehensive problem of the control of economic activity and development"[19] as the key practical problem of current social importance. Two reasons were offered for selecting the problem of control as the principal problem to be addressed by institutional economics. The first was Hamilton's assertion that there was "a general demand for control" [ibid., p. 313] to deal with problems incurred in the process of economic development. The "demand for control," like the demand for "a generalized description of the economic order" [ibid., p. 311], came largely from Hamilton and his fellow "protestants." The onset of World War I, had raised public awareness of the need for

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[18]. In The Control of Wages Hamilton wrote that "there are needed research organizations with competent personnels, who are able and willing to examine objectively proposals for economic change.... This they should do, working as the 'scientist' works, without passion or cosmic concern, making no commitment for or against the proposals" [Hamilton 1968; rpt., p. 80].

[19]. Hamilton did not provide a formal definition, but the full statement gives some examples of economic problems to be addressed:

> The many particular problems of the older period [prior to ascension of neoclassical value theory], concerned as they were with credit, taxation, corporation control, monopoly, unemployment, trade unionism, and immigration, are still at hand and clamoring for solution. But without losing their identities they are merging into the larger and more comprehensive problem of the control of economic activity and development [Hamilton 1918c, p. 399].

government policies to guide the course of economic affairs during war-time.[20] This provided a rationale for a liberal program of government intevention into the economy.[21] However, the notion that control should be consciously exercised over the evolving economic order was a central theme of Hamilton's research before the United States became involved in World War I. "Through his first book,... Current Economic Problems (1915), Hamilton began his effort to formulate the 'art' of the control of industrial development" [Dorfman in Hamilton 1974, p. 8]. In the preface to Current Economic Problems[22] Hamilton

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[20]. As George Soule remarked:
> For the first time in the history of the nation it became necessary to understand this sprawling and confused giant as a whole, to tame it and direct it toward consciously reasoned purposes.... Many had never even grasped the idea that in modern warfare economic preparations ought to be made before the outbreak of hostilities. All these habits persisted until the United States declared war on Germany in 1917, and were difficult to eradicate even during the following months.... Agencies of control were created in confusing array, altered, brought into conflict with one another, coordinated and recoordinated, until finally, when the war was over, something like order had emerged [Soule 1947, p. 9].

[21]. The details of the proposals for government intervention are discussed in the following chapter.

[22]. Page references are to the third edition [1925]. While the selection and arrangement of articles changed from the first to the third edition, Hamilton's contributions remained virtually the same. Note also that portions of Hamilton's unpublished dissertation entitled "Medieval Ideals of Authoritarian Control" are said to have been placed in Current Economic Problems [Dorfman in Hamilton 1974, p. 8]. The dissertation itself is unavailable.

began with the statement: "If intent has found expression in accomplishment, this volume is best described by its subtitle, 'A Series of Readings in the Control of Industrial Development'" [Hamilton 1925, p. xi]. Part I of the book was devoted to "The Problem of Control" [ibid, p. 1]. It would appear, therefore, that Hamilton's belief in the need for controlling the development of the economic system had roots in his earliest scholarly endeavors.[23] Nonetheless, his assertion in 1918 that control had "come to be the vital social problem," [Hamilton 1918c, p. 399, emphasis added] would likely have been an appeal to the need for war-time planning.

## Institutions and Control

The second reason given by Hamilton for the relevance of institutional economics to the problem of control was the "discovery that institutions are social arrangements capable of change rather than obstinate natural phenomena,..."[24] [Hamilton 1919a, p. 313]. Institutions were said to be

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[23]. Also, recall that Hamilton attributed to Cooley, one of his teachers in graduate school, the revelation that "our choice is not between regulation and letting things alone, but between one scheme of control and another" [Hamilton 1929, p. 185].

[24]. This "discovery" was, according to Hamilton, part of the general intellectual environment which helped to engender "protestant" economists like Robert Hoxie [Hamilton 1916, p. 859]. See chapter 2.

"directive agencies," while "[c]ontrol is exercised through the peculiar agencies which we have at hand" [ibid.]. Thus, to be relevant to the problem of control institutions should be the "subject-matter of economic theory" [ibid., p. 313] according to Hamilton's third test of economic theory. The importance of institutions and their relationship to the problem of control was summarized in the following statement:

> The demand that economic theory relate to institutions is implicit in the plea for its relevancy. If it is to be germane to the problem of control it must relate to changeable elements of life and the agencies through which they are to be directed.... A control of particular aspects of economic life requires a knowledge of particular institutions.... In like manner a control of the development of industrial society is contingent upon a knowledge of the bundle of conventions and arrangements which make it up [ibid., pp. 313-314].

Although this passage makes clear the importance of studying institutions in order to address the problem of control, it does not fully explain the nature and function institutions themselves. Hamilton's holistic definition of institutions continued into his fourth and fifth tests of economic theory.

## Institutions and Matters of Process

Hamilton's fourth test of economic theory was that it must be "concerned with matters of process" [Hamilton 1919a, p. 314]. Here Hamilton took up the cause of making

economics an evolutionary science. As discussed in chapter 2, the growing appreciation of evolutionary theory had considerable influence on Cooley, Veblen, and other "protestants." As Veblen put it: "Any evolutionary science,... is a theory of a process, an unfolding sequence" [Veblen 1990, p. 58, emphasis added]. In Cooley's words, neoclassical "political economy deals with social process almost wholly in its immediate and somewhat transitory aspects -- such as that of market valuation -- and is not, in a large sense, a science of process at all" [Cooley 1969; rpt., p. 259, emphasis added].

Carrying on in this "protestant" tradition, Hamilton argued that neoclassical economics failed as economic theory because value theory was static and mechanistic, dealing with economic phenomena only as quantitative variables which invariably return to a state of equilibrium in conformance with immutable laws (e.g., the "laws of supply and demand") [Hamilton 1919a, p. 314]. According to Hamilton,

> economic theory cannot be handled in any such way. Competition, property, the price structure, the wage system, and like institutions refuse to retain a definite content. Not only are things happening to them, but changes are going on within them..., each of these institutions is in process of development [ibid., p. 315].

This statement points to another defining characteristic of institutions as Hamilton conceived them: institutions, unlike the immutable laws upon which neoclassical value theory depends, are subject to change [ibid., pp. 313, 316].

In order to pass Hamilton's fourth test of economic theory a different method had to be adopted by economists which would enable them to explain the process by which the economic system as a whole changes. Hamilton called this the "genetic" method of analysis. He distinguished the genetic approach from a "historical account" because it "goes to the past only with the end in view and so far as is necessary to explain what a thing is in terms of how it came to be" [ibid., p. 315]. By these remarks Hamilton not only made a distinction between history as a method of approach and as a separate discipline, but also disassociated his approach to economic theory from that of the German historical school.[25] Furthermore, Hamilton's genetic method of analysis was holistic in that the "complex of institutions which together make up the economic order" must be dealt with as "a unified whole which is in process of development" [ibid.]. This was to say that the individual institutions making up the economic order (e.g. markets) could not be understood in isolation, but only in so far as they relate to other institutions.[26]

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[25]. Hamilton's view of the failure of the German historical school was that it threatened "to dissolve the science into a thousand particular inquiries" [Hamilton 1918c, p. 380].

[26]. Allan Gruchy defined holism in this way: "The post-Darwinian type of scientific thought which Smuts describes as 'holistic' takes the physical world to be an evolving, dynamic whole or synthesis, which is not only greater than the sum of its parts, but which also so relates the parts

The requirement that economic theory treat institutions as emerging through a process of development also relates to the second test of economic theory -- that economic theory must be relevant to the problem of control.

> If control is to be exercised, it is not to be by tinkering with this or that. It must be by changing the nature or functions of the institutions which make up our scheme of economic life. To insist upon treating such things genetically or as in process is nothing more than to insist that they are subject to conscious control [ibid., p. 316].

Here Hamilton provides another defining feature of institutions specifically and the institutional approach as a whole: institutions which serve to control economic activity are themselves "subject to conscious control" [ibid.]. This notion was contrasted with neoclassical economics in that "[i]ts explanatory terms are not matters subject to control" because both "economic statics" and "economic dynamics" rely upon "mechanical formulas" which are based upon immutable laws [ibid., pp. 313, 315]. These formal laws were, in turn, derived from what Hamilton saw as an inadequate theory of human behavior. This brings us to the fifth and final test of economic theory.

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that their functioning is conditioned by their interrelations" [Gruchy 1947, p. 4].
This appears to correspond closely with Hamilton's "genetic" treatment of the "unified whole" [Hamilton 1919, p. 315].

## Institutions and Human Behavior

The fifth test of economic theory was that it "must be based upon an acceptable theory of human behavior" [ibid., p. 316]. Neoclassical value theory was said by Hamilton to fail this test because of its adherence to a psychology based on "extreme individualism, rationality, and utilitarianism..." [ibid.]. Moreover, the neoclassical approach had made "a pecuniary expression of self-interest a part of human nature" [ibid.].

As Hamilton conceived of it, individual self-interest, "is not a simple thing that can be easily discerned, but a huge bundle of conflicting values wherein the present and the future are at variance" [ibid., p. 317]. Conflicting values resulted from a lack of complete knowledge on the part of individuals with respect to the available courses of action, and an inevitable conflict between the immediate interests of individuals and the future consequences of such action to society as a whole. This was a fundamental reason why Hamilton rejected the laissez faire orientation to economic policy in favor of active government intervention in the economy.[27]

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[27]. The idea of conflicting values and uncertainty in decision-making is discussed further below. The most thorough illustration was in Hamilton's work on specific economic problems. This is addressed in the following chapter.

The theory of human behavior required to pass the fifth test of economic theory was "a theory of motives... which is in harmony with the conclusions of modern social psychology" [ibid., p. 316]. The modern social psychology to which Hamilton referred recognized the role of instinct, impulse and "most important of all,... institutional situations impinging upon individuals" [ibid., p. 317]. The latter Hamilton believed were "the chief source of differences in the content of their behavior" [ibid., p. 317].

Hamilton did not cite the source of this "modern social psychology." Charles H. Cooley was undoubtedly an influence, having been cited by Hamilton as the teacher who "led us away from atomic individualism, made us see life as an 'organic whole,' and revealed to us 'the individual and society' remaking each other in an endless process of change" [Hamilton 1929, p. 185]. Referring back to Cooley's notion of "human nature values" and "institutional values,"[28] it is clear how Hamilton would come to see institutions as the major influence upon human behavior. Recall that in Cooley's sociological theory "human nature values" spring from the basic needs of all homo sapiens. The manner in which these needs are met, on the other hand, is largely a function of the prevailing social institutions. Because humans are inherently social beings "needs and values,... cannot be understood by direct reference to

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[28]. These were discussed in chapter 2.

universal human nature...." [Cooley 1966; rpt., p. 287]. Rather, "[a]ll human values are more or less mediated by special social conditions,..." [ibid.]. This notion corresponds closely to Hamilton's remark: "It is the institution in its role of organizer which makes of this a social and not monadic world" [Hamilton 1930, p. 84].

Now it becomes clear why Hamilton believed that neoclassical economics was mistaken in making the "pecuniary expression of self-interest a part of human nature" [Hamilton 1919a, p. 316]. Rather, the "pecuniary expression of self-interest" was merely an example of institutionalized behavior. "About every urge of mankind an institution grows up; the expression of every taste and capacity is crowded into an institutional mold" [Hamilton 1930, p. 84]. Simply put, while there is a common genetic inheritance which can be called "human nature," individual behavior in a particular social context reflects the institutions that "constitute standards of conformity from which an individual may depart only at his peril" [ibid.].

The concept of institutionalized behavior was best illustrated in "The Price System and Social Policy" [Hamilton 1918a]. In this article Hamilton argued that the institution of the price system exercised a type of "tyranny" over the behavior of individuals, effectively restraining any movement towards reform of the economic

system for the purpose of enhancing social welfare [ibid., p. 45,].

> Proposals are not accepted or rejected upon a consideration of their nature and of the eventual promises which they offer. Their fate rests upon the effects of their adoption upon current pecuniary incomes [ibid., p. 63].

Hence, an individual's immediate interest in pecuniary income, an institutional value, could conflict with longer term social values. As Hamilton put it, "my life and yours is a continuous thing..., what I do today constrains my acts tomorrow" [Hamilton 1919a, p. 317]. This was Hamilton's way of saying that decisions are made in historical time, without perfect information, and without certain knowledge of the outcome of particular choices. In the absence of perfect information and certainty of outcome, individual behavior is guided by institutions in the sense of "a way of thought or action of some prevalence and permanence, which is embedded in the habits of a group or the customs of a people"[29] [Hamilton 1930, p. 84].

By replacing the individualistic psychology of neoclassical economics with a social psychology, Hamilton made the "scheme of institutions under which one lives and must seek his good" [ibid.] the key determinant of how individuals express their valuations. Because pecuniary values are a reflection of evolving institutional

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[29]. As noted in chapter 4, Hamilton's references to historical time and uncertainty seems to anticipate Keynes's application of these ideas to macroeconomic theory.

arrangements, this effectively dismisses them as a measure of an individual's "utility" or "welfare." The meaning of economic welfare is itself defined by prevailing social institutions.[30] Furthermore, because institutions were, for Hamilton, the most important influences upon human behavior, and subject to conscious control, then the possibility -- and desirability -- of using social reform to enhance human welfare becomes evident.[31]

## Summing Up the Institutional Approach

Hamilton's five tests of economic theory served to both critique neoclassical theory and to outline an alternative paradigm for the discipline of economics. While the five tests could be interpreted as a methodological critique of orthodox economics, Hamilton stated, on the contrary, that he was not interested in a "pointless struggle over method," instead stating that the "real issue is over what economic theory is all about" [ibid., p. 309]. Hamilton's goal was, according to Dorfman, to advance "economics as an instrument of social progress" [Dorfman in Hamilton 1974, p. 5]. Because the dominant paradigm of neoclassical economics was

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[30]. This was Hamilton's argument against J. R. Hobson's use of a "hedonistic calculus" in the latter's Work and Wealth [Hamilton 1916, pp. 574-577].

[31]. The application of this notion will be clearly seen in the following chapter, especially as it was applied by Hamilton to wages.

seen as an impediment to this goal, Hamilton sought to replace it with an alternative paradigm.

Hamilton was encouraged in this endeavor because of the existence of other "protestants" who rejected neoclassical value theory as the one true approach to economic theory, and by a growing acceptance of the need for government intervention in economic matters in order to insure the success of the war effort. Thus Hamilton saw "the possibility of the emergence of a new economics, whose problem it is to explain the institutions which together make up the economic order, of which particular disciplines are mere aspects" [Hamilton 1918c, p. 406]. This new economics -- institutional economics -- would unify economic science by giving theoretical status to inquiries that relied primarily on generalized description, as opposed to deductive logic. The subject matter of these generalized descriptions would be institutions, that were analyzed using a "genetic" method. Hamilton's genetic method was a historical and evolutionary method of inquiry because institutions had to be explained in terms of the historical process through which they came into being. It was "organic," or holistic, in the sense that institutions were to be described in terms of their functions and relations to other institutions in the economic order as a whole. An important function of institutions was that they exercised a significant influence over human behavior. This in turn

made institutions instruments of social control. Because institutions change, Hamilton assumed that they could be consciously altered in order to produce a desired social outcome; institutions were themselves subject to control.[32]

Hence, the genetic study of institutions, would provide the knowledge necessary for controlling the development of the economic system. In this way the discipline of economics would become the "instrument of social progress" [Dorfman in Hamilton 1974, p. 5] Hamilton believed it should be.

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[32]. It is important to emphasize that in Hamilton's holistic approach, individual behavior, while rooted in human nature, is directed by institutional arrangements. Individuals are, however, capable of remaking their institutional environment. See Chapter 2, p. 22, including fn. 11. This point will be useful in distinguishing Hamilton's institutional economics from the Veblen-Ayres variant discussed further in Chapter 5.

# CHAPTER 4

## THE PRACTICE OF INSTITUTIONAL ECONOMICS

### Introduction

The purpose of this chapter is to illustrate the manner in which Hamilton put his institutional approach to economic theory into practice through its application to practical economic problems. Examples of the problems Hamilton analyzed include the demobilization of labor following World War I, the control of wages, pricing policies, and the troubled bituminous coal industry in the United States of the 1920s.

As explained in chapter 3, "The Institutional Approach to Economic Theory" [Hamilton 1919] ended the period during which Hamilton was formulating his theoretical alternative to neoclassical economics. Beginning with his appointment to the War Labor Policies Board in 1918 Hamilton began using his institutional approach to analyze practical economic problems. Thus, 1918 marks the point in Hamilton's career where the emphasis of his work began to shift from formulating economic theory in the abstract, to becoming a practitioner of institutional economics.[1]

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[1]. Recall that one of the characteristics of institutional economic theory was that it should be relevant to practical economic problems. Therefore, in addressing real-world economic problems Hamilton was practicing institutional economic theory as he had conceived it. See

This analysis of Hamilton's practice of institutional economics will cover four of his major efforts to apply his nascent paradigm to practical economic problems. Hamilton's wartime writings, being the earliest examples of the application of his institutional approach, will be analyzed first. The second topic is, The Control of Wages [Hamilton and May, 1968; rpt.] which contains Hamilton's theory of wages[2], and provides an illustration of how he viewed the relationship between theory and practice. Third will be Hamilton's contribution to Price and Price Policies [Hamilton ed., 1938]. Price and Price Policies and The Control of Wages are similar in that both provide an intermediate step between Hamilton's writings on theory in the abstract, and his detailed application of the institutional approach to a specific economic problem: the two volume analysis of the bituminous coal industry.[3] As each of these works is discussed it should become evident that each presents a model problem which Hamilton analyzed

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"The Problem of Control" in chapter 3.

2. The Control of Wages was co-authored with Stacy May, one of Hamilton's students at the Brookings Graduate School of Economics and Government. The book contains a note explicitly stating which author wrote particular chapters. Hence it is possible to say without qualification that the "Theory of Wages" was Hamilton's.

3. The Case of Bituminous Coal [Hamilton and Wright 1926] and A Way of Order for Bituminous Coal [Hamilton and Wright 1928].

using the methods described in "The Institutional Approach to Economic Theory"[4] [Hamilton 1919].

## An Institutional Economic Analysis of World War I

Readings in the Economics of War was intended by its editors, John Maurice Clark, Walton Hamilton, and Harold Moulton, to serve as an introduction to "the problem of economic organization as it is conditioned by war" [Clark 1918, p. xiv] for undergraduate students and the general public. In the preface the editors revealed a key aspect of their approach to the subject:

> It is nothing less than a permanent overhauling of our economic institutions which war has thrust upon us. Hence this book is the expression, not merely of the economic side of the war, taken as a detached event, but rather of the part the war plays in the evolution of our economic institutions [ibid.].

As can be clearly seen in the above passage, the author's made evolving economic institutions the focus of their study. This corresponds directly to the third and fourth

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[4]. A brief note is in order to explain why these particular books and articles were selected for analysis in lieu of Hamilton's many other works. Although Hamilton produced several other articles and books between 1918 and 1938, as well as after 1938, his focus began to shift to the analysis of specific legal institutions such as patents, anti-trust law, etc. For example, The Power to Govern [Hamilton, 1937], written with Douglass Adair, is an interpretation of the language found in the Constitution concerning commerce and the powers of the government to regulate economic activity. These works are not analyzed because they do not directly concern the sources, nature and influence of Hamilton's institutional economics.

"tests of economic theory," or "characteristic of institutional economics," in Hamilton's "Institutional Approach to Economic Theory" [Hamilton 1919]. These were that institutions were the "proper subject-matter of economic theory" [ibid., p. 313], and that "economic theory is concerned with matters of process" [ibid., p. 314].

Hamilton's second test of economic theory--relevance to the "modern problem of control" [ibid., p. 312]--was also addressed in the preface to Readings in the Economics of War. The following passage reveals the "problem of control" as a prevalent theme of the editors:

> Some critics may feel that the tone of the book is unduly favorable to the scheme of control which the war has brought into being. It is far too soon, in fact, to attempt a final estimate of success or failure in our actual performance, and hence the effort here has been rather to show the principles that must underly such control [Clark 1918, p. xiv].

Thus, Clark, Hamilton and Moulton appear to have shared a common belief in the need for social control of the economic system through the use of public policies to create or modify social institutions in order to meet the needs of a war-time economy.

Moreover, the authors rejected the notion that with the cessation of hostilities the United States could discard those instruments of public control over the economic system which had been created in order to foster the war effort.

> The number of laborers, the amount of capital, and the state of natural resources have been too much affected; the scheme of industrial relations, the

> control of the government over industry, and the domain of direction and guidance have been too greatly changed; and the habits, thoughts, and ideals of the people have been too much modified for that [Clark 1918, pp. xiii-xiv, emphasis added].

Clark, Hamilton, and Moulton, appear to have viewed World War I as a turning point at which society might be able to shed its adherence to the laissez faire philosophy of government, and recognize what the "protestants" already knew: the economic system was not self-regulated by immutable market forces, but rather controlled by a complex of changing institutions, the evolution of which could be directed through public policy.[5] Readings in the Economics of War can, therefore, be interpreted as an early example of "institutional economics" in practice, even though Hamilton had not yet publicly offered that formal title.[6]

The markets for food and labor were two specific areas that were analyzed by Hamilton. In the only contribution to

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[5]. As discussed in the preceding chapter, the "protestants" to which Hamilton referred were those economists who rejected the dominance of neoclassical value theory, and could supposedly be united in "a common enterprise" wherein:

> control sets the problem, welfare fixes the end, institutions are the changeable factors through which control must be exercised, and the whole is an affair of development which must be dealt with genetically,... [Hamilton 1918c, pp. 404-405].

[6]. The preface to Readings in the Economics of War is dated September 2, 1918. Recall that presentation of "The Institutional Approach to Economic Theory" to the American Economics Association was given in December 1918, and published the following year in the Proceedings issue of the American Economic Review.

Readings in the Economics of War in which Hamilton was listed as the sole author, he took up the question of constructing a food policy to deal with the anticipated shortages brought about by the war.[7] As discussed in the preceding chapter, in Hamilton's institutional approach, the price system is treated as merely one institutional arrangement among many which exert control over economic activity. With respect to provisioning for the war effort, Hamilton was skeptical of the ability of an unregulated price system to meet the nation's needs:

> One's experience in business, large or small, tells him that money is the indispensable means to the goods he craves.... But further consideration shows that money is not the thing which is needed.... in at least two very important respects the nation's needs are unlike yours or mine: first, it requires goods in unprecedentedly large quantities, and secondly, it demands many goods which the market does not supply. It asks of the industrial system what it has not been in the habit of furnishing [Hamilton 1918d, pp. 612-613].

By noting that a nation's needs in war-time are fundamentally different from the individual's, Hamilton exhibited the holistic ("organic") nature of his approach, in clear contrast to a market-oriented analysis based upon methodological individualism.[8] Moreover, in utilizing his

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[7]. "The Requisites of a National Food Policy" was adapted from an article published in The Journal of Political Economy [Hamilton 1918d]. Citations are to the JPE version.

[8]. "We need constantly to remember that in studying the oragnization of economic activity..., we are dealing with a unified whole...." [Hamilton 1919a, p. 315, emphasis

institutional approach to analyze provisioning for the war effort, it was apparent to Hamilton that additional instruments of control were a necessary addition to markets in order to assure that the required goods would be forthcoming in sufficient quantities and not at "unnecessarily high expense" [ibid., p. 613].

Hamilton then turned to the problem of defining the needed instruments of control. He began by analyzing the quantity of food produced versus the quantity consumed by both the belligerent and neutral nations most affected by the conflict. Hamilton estimated that there would be a significant shortfall in available food supplies in Europe, combined with a smaller than usual surplus in the United States. This was primarily due, according to Hamilton, to the diversion of large amounts of labor and capital to the war effort. In his estimation, without the exertion of some form of control other than global market forces, the price of food would rise to extraordinary levels causing hardships even to the populations of the countries producing an agricultural surplus. Therefore, control needed to be exercised, in Hamilton's opinion, on the behavior of both consumers and producers.

With regard to controlling consumption habits, Hamilton made it clear that policy makers would have to give

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added].

consideration to the way in which consumer tastes were formed:

> First and most obvious is the obligation which the food problem imposes upon the consumer.... As yet it is not so clearly appreciated that many of our expenditures upon food get their necessity from social convention rather than from bodily need or physical or mental vigor.... A great saving may be effected by keeping in mind the principle that the selection of articles for consumption must be based upon their food values rather than their customary positions in the dietary or social budget [ibid., pp. 634-635].

As one example, Hamilton criticized a Food Administration policy that required purchasers of wheat products to purchase "an equal number of pounds of bread materials made from other grains." In his view, the policy was shortsighted in that it did not attempt to educate the public in how to use the substitutes "to turn out products more in keeping with the conventional standards of American culinary technique" [ibid., p. 635]. Hamilton recognized that to make this forced substitution an effective instrument to reduce the demand for wheat, attention had to be paid to culturally ingrained habits of behavior, rather than relying on coercive measures alone. Hamilton was thereby utilizing the broader social psychology that was central to his institutional analysis. In Hamilton's view consumer preferences were not simply given data, but a function of the institutional environment within which the consumer functions. Therefore, Hamilton, the economist qua institutionalist, attempted to go beyond the analysis of

consumer's reactions to changing prices in order to examine the "institutional values" of consumers.[9] Moreover, Hamilton was also concerned with how consumer habits might be modified in order to achieve the socially desirable end of making the best use of available food products. Thus, Hamilton did not feel compelled to limit his economic inquiry to a mechanical analysis of relative prices. Rather, the institutionalized behavior of consumers was itself a variable capable of being changed with appropriate policy measures.

With regard to the behavior of producers, Hamilton again rejected the price system as an effective means of control:

> Second is the burden which the food problem imposes upon the producer... Under present conditions a non-regulated price system is not a proper guide to agricultural production. It has the double failing of leading too many people to produce articles which in the previous system have commanded high prices, to the end that the quantities of staple commodities are not properly apportioned, and of allowing the production of articles to suit the whims of those who can afford to pay.... the real solution of the problem calls for positive policy on the part of government. By absolute prohibition, or by a denial of the use of essential materials, the state must see to it that food resources used in the production of nonessential food commodities be diverted to the production of essential commodities [Hamilton 1918d, p. 636].

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[9]. Recall from Chapter 2 that Hamilton's mentor Cooley, distinguished between "human nature values," (e.g. the basic need for food) and "institutional values," (e.g. the type of food customarily consumed) [Cooley 1968;rpt., p. 285ff]. Pecuniary values were said to be mainly the result of institutions as opposed to human nature.

In this statement it is clear that Hamilton was advocating another modification of institutional arrangements: the addition of production policies to further the goal of a successful prosecution of the war. In constructing such a policy, social values, for which there was no effective demand in the market, would have to be realized through an the agency of state. This was necessary because the market would automatically tend to serve the preferences of those with the greatest ability to pay, thereby diverting resources toward the production of luxuries. Hence, the goal of maintaining an adequate supply of staple food for the great mass of the population required the addition of another instrument of control. In short, Hamilton felt the institution of the price system was not adequate for controlling either consumption or production activities given the nation's extraordinary needs.

Hamilton continued his institutional analysis of the effects of war on the economy in "The Rate of Demobilization and the Labor Market," [Hamilton 1919b] published shortly after Readings in the Economics of War. In that article Hamilton expressed his belief in the need for authoritarian control over the rate at which military personnel would be demobilized following the cessation of hostilities. In the absence of such control, the most likely scenario, according to Hamilton, was that "labor will come to market faster than it can find employment," resulting in "lower wages and to

break down labor standards" [ibid., p. 323]. Hamilton thought that this would be seen by individual business firms as a favorable development, but in pointing out the hazards of declining wages in the aggregate, he again focused on the social consequences such a development, as opposed to individual costs and benefits. In what can be interpreted as an anticipation of Keynesian macroeconomic theory Hamilton wrote:

> The second result of a large volume of unemployment will be the disorganization of the purchasing power of the masses.... In considering the dangers in this emergency one must not forget that the producer's ultimate market is the purchasing power of employees in other establishments [ibid., p. 324].

Hamilton had envisioned an insufficiency of aggregate demand resulting from rapidly falling wages, leading in turn to a downturn in economic activity.[10] This provided Hamilton with a rationale for government intervention in the labor market.

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[10]. In the General Theory Keynes dismissed sticky wages as the cause, and falling wages as the solution, to involuntary unemployment for two reasons. First, workers only negotiate their nominal wage and have no control over the real wage they receive. Even if nominal wages decrease, the level of real wages depends on the direction and magnitude of change in the price level. With prices apt to fall during a depression, nominal wages would not only have to decline, but at a faster pace than the decline in the price level in order for firms to increase the quantity of labor demanded. Second, a decrease in wages also results in a decrease in the purchasing power of workers. A decrease in the wage rate will increase profits, and thereby stimulate employment, only if the effect of declining costs is greater than the effect of declining demand. See Keynes 1964 rpt., especially chapters 2, 3, and 19.

Hamilton's proposal for resolving the labor situation was based upon an analysis of the controls available to government with respect to the various pools of labor that were to be demobilized. Hamilton divided potential entrants into the labor market into five categories: "(1) the men under arms overseas; (2) the men under arms in this country; (3) the workers in war industries; (4) prospective immigrants; and (5) young people bringing their labor to market for the first time" [ibid., p. 325]. The rate at which the first two groups were discharged was completely under the control of military authorities and thus the instruments of control were already available. However, Hamilton recognized that delaying the release of military personnel in this country would appear to be wasteful given their proximity to their homes and the lack of military duties for them to execute. The choice was therefore complicated by two conflicting values:

> The one which impels haste is the desire to avoid the costs which attend their retention under arms and the waste of their labor while maintained in idleness,.. [and] the one which urges delay is the fear of flooding the labor market and causing unemployment.... [ibid., p. 326].

If the prevention of unemployment were given precedence, Hamilton warned that it might be hard to maintain discipline in the peacetime armed forces once the "supreme objective which underlies morale is gone" [ibid.]. Conversely, unemployment would erode "industrial morale," raising the

threat of "bolshevism" [ibid.]. Once more it can be seen that Hamilton was utilizing a social psychology to evaluate the process by which individual and group interests may interact to produce undesirable results.[11]

The third group of workers in war industries was under the indirect control of the military: the rate at which they would enter non-military labor markets would depend upon the rate at which contracts for munitions were canceled. Hamilton observed that this might also have been a difficult question for policy-makers except that the government bureaucracy had its own inertia which would "make the process of cancellation far more intelligent than officialdom had intended" [ibid.]. The fourth and fifth groups were dismissed by Hamilton as being "of no great importance" [ibid.].

In order to address the problem of wasting resources, inherent to any policy of restricting the rate of discharge of military personnel, Hamilton proposed a new institutional arrangement as an instrument of control. It would have been an active government policy designed to facilitate the reintegration of labor into post-war industry. Although he did not provide a detailed account of such a policy, Hamilton summarized its main features as follows:

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[11]. "[S]elf-interest is not a simple thing that can be easily discerned, but a huge bundle of conflicting values wherein the present and the future are at variance" [Hamilton 1919a, p. 317, emphasis added].

> First, and most essential, it can gather and organize information about the extent and localization of the resumption of industry and the employment which it may be expected to offer. Second, a proper scheme of priorities in the discharge of men can be made of great value.... Third, the cancellation of war contracts can be premised, among other things upon an effort to arrange the rate and priorities in such a way as to speed the resumption of industry. And fourth, by a judicious withdrawal of the control which the government has exercised over priorities and over prices, much can be done to remove the incubus of hesitation which threatens to slow up the industrial machine [ibid., pp. 327-328].

Beyond this "modest" set of proposals, Hamilton alluded to more comprehensive actions which the government might have been able to undertake "had the powers-that-be taken thought in time" [ibid., p. 328]. These would have involved government planning for the post-war economy and underwriting business ventures for the purpose of alleviating the uncertainty involved with the transition to a peacetime economy. In another statement which anticipated Keynesian economics, Hamilton argued for an active government policy in this area:

> if one concern hesitates because of an uncertain market, others may be expected to do the same... By effective guarantees the government could remove risks and stimulate all to produce together. If all went ahead, each would find a market for his wares[12] [ibid., p. 328].

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[12]. More specifically, this is an anticipation of the post Keynesian interpretation of how uncertainty was viewed by Keynes. Keynes is said to have used uncertainty in the sense of that which is unknowable, differentiating it from risk as a calculable probability. cf. Davidson 1978, chapter 2.

Although the opportunity for such a comprehensive plan for economic transition had already passed in Hamilton's estimation, the maintenance of sufficient effective demand could still be assured through the pursuit of public works projects "to provide what we may call 'buffer employment' at a time when the threat of a glut of the labor market and of industrial disorganization is most acute" [ibid., p. 329].

The end of World War I did not mark the end of Hamilton's efforts to analyze economic problems using his institutional approach to economic theory. According to Joseph Dorfman: "The war strengthened Hamilton's faith in social control" [Dorfman in Hamilton 1974, p. 10]. With this in mind I now turn to Hamilton's post-war writings.

## The Control of Wages

The Control of Wages [Hamilton, 1968; rpt.] may be viewed as a text on a practical problem of organized labor -- how to raise the rate of real wages.[13] At the same time the book contains "A Theory of Wages," and thus it is also an example of how Hamilton conceived of the relationship between theory and practice.

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[13]. This book was prepared as part of The Workers Bookshelf series that was intended to provide educational materials to wage labor. In a note prefacing the book it is stated that "[a] large part of the argument for 'The Control of Wages' which is set forth in this book was tried out in 'the classes for workers' in Holyoke and Springfield, 1920-1921; 1921-1922" [Hamilton and May 1968; rpt., n. pag.].

To Hamilton the practical problem of raising the real wage gave The Control of Wages its unifying theme.[14] Nonetheless it is also a theoretical work because it provides a generalized description of the institutions that determined wage rates. Hamilton's goal was to construct a theory in "general terms" which could explain any rate of wages [ibid., p. 31].

An important aspect of Hamilton's analysis of wages is his perspective on the relation of income to the welfare of its recipient:

> The purchasing power which the wage possesses fixes the limit of 'the standard of living' which its earner can set up for his household. The surplus of that wage over conventional necessities measures the opportunities of his family for development. If our culture is to be democratic, if the common man is to have access to 'the fullness of life,' it must be by the grace of the plain, ordinary 'pay envelope' [ibid., p. 13].

Hamilton understood the importance of wages to be both its role in providing "the bait with which society tempts the laborer to engage in one of the processes of production" [ibid.], and in allowing the laborer to move beyond meeting

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[14]. This is in contrast to the approach of using a logical construct. Recall Hamilton's criticism of Mill's Principles cited in chapter 3. "Quite inevitable the category of wealth which [Mill] chose robbed the volume of the organic unity which a problem would have imparted and left a mechanical entity in its place" [Hamilton 1918a, p. 241] Mill's failing, according to Hamilton, was in making the Principles a battleground for the "clash between two rival conceptions of economics" [ibid., p. 242]; the institutional approach employing generalized description and the mechanistic logic which came to be the method of neoclassical economics.

basic human needs to unspecified forms of cultural attainment. For this reason Hamilton believed that raising wages was the sine quo non of cultural development for the masses who depended upon wage labor for their livelihood.

Reiterating a theme used in "The Price System and Social Policy," [Hamilton 1918c] Hamilton argued that industrialization, with its division of labor into specialized functions, had made laborers dependent upon the price system for their subsistence and well-being.

> This 'coming of industrialism' to America has made the laborer dependent for his living, his welfare, and his development, upon a vague, mysterious, and powerful 'system of prices.' His economic existence is pent up within two sets of prices: the price at which he can dispose of his labor and the prices at which he can purchase the goods and services which appear upon his household budget [Hamilton 1968; rpt., p. 15].

Thus, it was the institution of the price system that, in Hamilton's view, played the largest role in determining the welfare of the working population.[15]

According to Hamilton there were two conditions which had to be met in order to realize the normative end-in-view of increasing the welfare of that segment of the population which depended upon wages for income. The first was that "the wage should be regular:" as the workers' needs were

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[15]. This sentiment was underscored with the remark that "[i]f the system of prices withholds advantages from the families of working men, the community is not developing and using to the full its human resources. As a result its culture must remain upon a lower level" [Hamilton 1968; rpt., p. 17].

regular and recurrent, so too the wage must be regular for those needs to be met. The second was that "the wage should be adequate." The notion of adequacy would seem to require more explanation than was provided. However, Hamilton found it so obvious that "at present the average wage falls so far short of even a modest definition of adequacy" that there was no reason to say more than "'enough' need mean no more than that wages be raised as much as they can" [ibid., pp. 17-18]. In this way Hamilton excused himself from having to provide a quantitative definition of an adequate wage.

Having specified the problem to be addressed, Hamilton and his coauthor Stacy May turned to the question: "must the wage-earner have his life dominated by his wages, or can he bring his rebellious wage under control?" [ibid., pp. 18-19]. To answer this question Hamilton began by examining the argument against attempts to control the rate of wages inherent to the neoclassical approach. Attacking the "natural law" foundations of neoclassical economics, Hamilton asserted that "'supply and demand' is not a 'law of wages'" [ibid., p. 22]. Employing his own theoretical approach, Hamilton initiated a search for those institutional elements which were amenable to social control and thereby could become instruments to be used in attaining the desired social end. With this in mind he articulated the components he believed made up the demand for and supply of labor:

> The demand for labor is a compound of the volume of industrial equipment, the efficiency of technique, the quality of management, the demand of the public for the products of labor, and kindred elements. The supply of labor is a matter of the number of laborers, their training, their experiences, their abilities, their organization, and similar qualities. The popular argument against control thus becomes a question of whether or not these more elementary factors upon which wage rates rest are subject to human guidance [ibid., p. 22].

Hamilton would, therefore, focus his attention on the non-price determinants of supply and demand, viewing them as institutional arrangements that were malleable, and therefore subject to conscious control.[16]

Having made a case for the control of wages, Hamilton set about the task of enumerating the methods by which real wages might be increased. The immediate goal, in Hamilton's terminology, was to "find the increment," [ibid., p. 32] or source, of additional income for workers. In general terms there were three ways to raise the rate of wages. First, an increase in the nominal wage could be obtained from "the pecuniary incomes adjacent to the rate of wages, technical improvements in the process of production, and changes in

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[16]. Where the neoclassical model explains how price and quantity return to a state of equilibrium <u>given</u> a new set of non-price determinants, Hamilton's institutional approach attempts to explain these variables in terms of how they change and to what extent they can be controlled. For example, the "specific productivity of labor" was to Hamilton a "blanket term for an agglomeration of all the pecuniary, technical, and economic conditions affecting wages" rather than an attribute of labor. "It, therefore, becomes necessary to break it up into its elements, and to determine whether these are subject to control" [Hamilton 1968; rpt., p. 27].

the organization of industry" [ibid.]. Second, the price of the goods and services consumed by labor could be reduced, thereby raising the real wage. Third, the laborer's "free income," consisting of such items as "accident compensation, health service, the use of parks, and educational opportunities" could be increased [ibid., p. 33]. Focusing most of his attention on the first of these three methods, Hamilton developed a theory of wages based on an analysis of the "acquisitive arts," "industrial arts," and "economic arts."[17] Each of these sources of an increment to the rate of wages will be discussed in turn.

The "acquisitive arts" [ibid., p. 34] referred to methods of raising wages through the appropriation of existing income. Hamilton enumerated five groups from whom workers might extract additional income. These were consumers, recipients of investment income, owners of natural resources, salaried employees, and materials suppliers. Because each group presented particular obstacles and limitations to the redistribution of income, Hamilton was not especially optimistic concerning this source of additional wages.

The consumers of the laborer's product, for example, could be made to bear the burden of higher nominal wages if the additional cost to the firm could be passed on in the

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[17]. As will become evident, Hamilton did not ignore the effect of raising nominal wages in the aggregate upon real wages in the aggregate.

form of higher prices. However, Hamilton recognized that the ability to pass along any increase in wage costs to consumers was limited by the price elasticity of demand for that product, thus providing a "check on collections whose destination is the pay envelope"[18] [ibid., p. 36]. Furthermore, should laborers in the aggregate attempt to raise their rate of wages through passing on higher prices to consumers they would find that, being consumers themselves, their real income was increasing only by the amount of real income extracted from those who did not derive their income from wage labor [ibid.]. Thus, the amount of real income to be redistributed from consumers to wage laborers was ultimately limited by the amount of dividends, interest, and rents which could be appropriated through higher prices.

Alternatively, workers could expropriate the income of the recipients of investment income directly. However, Hamilton held that while expropriation of this income was possible, it was not a practical option without "devising substitute ways of getting the functions performed which 'interest' and 'profits' now serve" [ibid., p. 39]. In the

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[18]. Note that in Hamilton's use of the neoclassical concept of price elasticity there is no inherent conflict with the institutional approach to economic theory. "An appeal for 'institutional economics' implies no attack upon the truth or value of other bodies of economic thought, but is a denial of the claims of other systems of thought to be 'economic theory" [Hamilton 1919, p. 309]. In other words, value theory has its place in economic theory, but is not in itself economic theory writ large.

end he was not convinced that other institutional arrangements for organizing investment in capital equipment would provide a significant increment to the rate of wages, even if they were organized in the most efficient manner conceivable.

Similarly, an increment in the rate of wages could be obtained by expropriating the income of the owners of natural resources. Two obstacles stood in the way of expropriating this form of property income: the "notion of the sanctity of property rights," and "the necessity for inventing and perfecting devices for getting at these 'unearned' incomes" [ibid., p. 41]. With regard to the former, this was seen by Hamilton as a deeply rooted "common sense" notion which was unlikely to be swept away given the prevailing attitude. As for the latter, Hamilton provided the example of levying taxes on economic rents accruing to the owners of inframarginal resources. He concluded that the tax revenues would be as difficult to get away from government as they were from owners.

To summarize Hamilton's view of the acquisitive arts; they offered little in the way of an increment in wages, and much in terms of institutional obstacles. For this reason he placed greater hope for increasing wages in methods of generating new and unappropriated real income.

A more promising means of finding an increment from which to raise the rate of wages was, according to Hamilton,

the "industrial arts:" advances "in the technical processes which make up industry" [ibid., p. 46]. In contradistinction to the acquisitive arts, Hamilton stated that improvements in the industrial arts produced a surplus[19] which is "as yet unappropriated, and is not represented by established interests. It constitutes an ever-present, attractive, and available fund with which to raise wages" [ibid., p. 47]. Moreover, because he saw no evidence to suggest that the industrial arts would ever be completely perfected, they represented a perpetual source of surplus real income.

Hamilton enumerated five categories for improvements to the industrial arts. These consisted of improving the efficiency of labor, the efficiency of management, the technique of industry, updating industrial equipment, and improving the organization within firms. Each of these

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[19]. At this juncture Hamilton begins using the term "surplus" in place of "increment." Although he does not define surplus precisely, the distinction, apparent from the context in which he uses the term, is that a surplus is an addition to output which is "as yet unappropriated," meaning that it could be used as an addition to profits, corporate saving, economic rents, or increased wages depending upon the institutions which assign claims upon income. At this stage in his analysis, Hamilton is engaging in an abstraction, looking at the institutions which control the production of additional output separately from those which assign claims upon them. In his section on the "economic arts" discussed below, Hamilton considers alternative institutional structures as a source of a "surplus," but as I will point out, these also include measures which do not necessarily increase output, but may instead reduce claims on existing income. Thus, Hamilton's conception of a "surplus" seems to be centered around creating "unappropriated" real income, new or otherwise.

categories was seen by Hamilton as being subject to conscious control insofar as they were the product of institutional arrangements.

For example, the "efficiency of labor" [ibid., p. 47] was a reference by Hamilton to what is now often referred to as "human capital." Hamilton proposed that increases in the efficiency of labor could be made by providing better nutrition and health care; providing better education and training; and finally, by making employment more regular through the control of the business cycle in order to raise laborers' morale [ibid., pp. 47-52].

Likewise, the efficiency of management could be improved through institutional adjustments. In the textbook case "the struggle for economic survival" eliminates inferior management, but according to Hamilton, "for all the laws made by economists, the establishment with an incompetent management is still in the land,..." [ibid., p. 54]. Hence, managers should be selected upon criteria of competence rather than "personal interest, kinship, acquaintanceship, and other alien considerations," and mechanisms needed to be developed whereby "marginal managements" would be discharged [ibid., p. 53].

In examining Hamilton's recommendations for improving the industrial arts, it could be said that his proposals for institutional adjustments were only vague generalizations. However, as he stated at the beginning of the book, the

argument would be made in general terms with not much provided in the way of specific application. As will be seen below, in Hamilton's analysis of the bituminous coal industry, more specific recommendations were possible in light of a more specific set of problems.

The "economic arts" was Hamilton's most general category which encompassed elements of both the acquisitive arts and the industrial arts because it consisted of studying "the institutions which make up the economic order" as a whole [ibid., p. 63].[20] Repeating his argument that the institutions making up the economic order were constantly changing, and therefore not immutable, but capable of conscious control, Hamilton addressed several economic factors related to producing an economic surplus with which to raise wages.

One institutional factor that, in Hamilton's view, hindered wage increases was "payments for the services of property" [ibid., p. 67]. Included in this category are payments to the owners of natural resources, tangible and intangible corporate assets. Hamilton questioned the

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[20]. Hamilton appears to be using "economic arts" as a popular term for "institutional economics," perhaps because the latter would not have been familiar to his intended audience of wage laborers. If this inference is correct, then it can be said that institutional economics, as Hamilton viewed it, was more of an "art," in contrast to the "science" of neoclassical value theory. As discussed in the previous chapter, this was not to deny institutional inquiries theoretical standing.

ethical basis of some of society's most revered institutions when he wrote:

> the ownership of natural elements in the creation of which man has had no part, should be vested in the community; private individuals should not be allowed to take tribute from 'intangible assets' created by the community's demand; and genuine investments should be paid with just enough to insure their continuous flow [ibid., p. 67].

But reallocating these payments to the wages of labor was a difficult proposition, for, according to Hamilton, "the barricades with which ownership has been hedged about are far more formidable and ingenious than the weapons which have been contrived for the attack" [ibid., p. 68]. One possibility Hamilton saw was in the "'liquidation of ownership'" [ibid., p. 69]. His rationale was that while "[t]he wages of one who works stops with his labor; the salary of the organizer ceases when his task is done; and even the income of the inventor from the property which he has created ceases after a term of years" [ibid., p. 68], the payments to ownership continue on indefinitely. However, Hamilton acknowledged that simple expropriation of property would be "unfair, since a great deal of it has changed hands many times and has been purchased by its current owner in all good faith" [ibid., p. 69]. Moreover, such a drastic revamping of social institutions would wreak havoc on the economic system. As an alternative, Hamilton proposed purchasing property rights with terminable annuities. This would compensate owners, while eliminating

the ownership charges against earnings within "forty or fifty years" [ibid.]. Once the claims to income from property had vanished, a surplus[21] would be available for higher wages.

Where Hamilton's proposal for the "liquidation of ownership" obviously overlapped with the "acquisitive arts," his proposals for the reorganization of industry overlapped with his analysis of the "industrial arts." Collective research was one example of an institutional arrangement that could produce a surplus. Small firms could pool their resources, and share in the gains resulting from improved industrial techniques [ibid., p. 73]. Hamilton went so far as to suggest "the complete unification of industry" [ibid., p. 75] as a strategy for raising wages. He then examined the probable consequences for unification through corporate monopoly, nationalization, and worker control. Corporate monopoly was found wanting as a device to raise wages because in the absence of strong unions there would be no assurance that whatever efficiencies might accrue to the

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[21]. Note that this is not the same "surplus" as that created by improving the industrial arts in that it is not a new addition to output. It would seem that Hamilton has blurred the distinction between "finding the increment" through redistribution of existing incomes -- the acquisitive arts -- and creating a surplus from new sources of real income -- the industrial arts. At this juncture the creation of "surplus" is simply disappropriating income from particular groups by eliminating their claims upon income. Hamilton can be rightly criticized for inconsistency in his disparagement of certain "acquisitive arts" while encouraging others under the name of "economic arts."

monopolist from "'collective marketing'..., 'collective research'... 'financial unification'" [ibid., p. 75] would be turned into higher wages. Moreover, the regulation of monopolies in the public interest was an unsure endeavor in Hamilton's view. Nationalization also was seen by Hamilton as an uncertain method of reorganizing industry. "Industries are not all alike; an organization ideally adapted to the post-office may be quite unsuited to coal"[22] [ibid., p. 77]. Having control of a unified industry vested in workers, or workers and consumers, is likewise a relatively untested approach. "It is only when analysis, the accumulation of fact, and careful and detailed restatement has reduced this general proposal to a specific, constructive program that a judgment upon it will be possible" [ibid., pp. 78-9]. As will be shown below, Hamilton's analysis of the bituminous coal industry prompted him to suggest a form of worker/consumer control.

As the title of the tenth chapter of The Control of Wages suggests, Hamilton viewed his contribution as "a theory of wages, not the theory of wages" [ibid., p. 105, emphasis original]. "This theory explains wages, so far as it explains them, from the standpoint of the single problem of how they may be raised through a conscious control of the

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22. As I will discuss further below, Hamilton specifically rejected nationalization, as well as private corporate monopoly and worker control, as solutions to the problems of the bituminous coal industry.

factors upon which they rest" [ibid., p. 105]. By addressing a specific economic problem--how to control the rate of wages--Hamilton was clearly focusing on one of the distinguishing characteristics of his institutional economics; it was addressing the "modern problem of control" [Hamilton 1919, pp. 311-312]. The congruity with "The Institutional Approach to Economic Theory" was also evidenced by the explicit emphasis on institutions. Hamilton stated that in his theory of wages the factors determining the rate of wages were "customs, habits, practices, conventions, and arrangements, all of human contrivance and all subject to human guidance" [Hamilton 1968; rpt., p. 108]. To summarize, wage rates could be controlled through institutions that are themselves amenable to control.

## Price and Price Policies

Where The Control of Wages provided an illustration of Hamilton's paradigm as it was applied to the question of how to raise wage rates, Price and Price Policies [Hamilton 1938] illustrates his institutional approach to analyzing prices. As editor of the volume, Hamilton provided only an introduction to the method of approach and some concluding

remarks, but no industry study.[23] However, Hamilton's contributions as editor do help to clarify his approach to the question of how prices are formed and his view of the role of economic research.

As in The Control of Wages Hamilton used a specific economic problem as the unifying theme for Price and Price Policies.

> The end of all industrial activity is obviously an enlargement of the material means to human welfare. So the studies presented here converge into the common question of whether the good is produced in a quantity large enough and sold at a price low enough to have and to hold a secure place in the American standard of living. And to those of us who cannot escape an interest in the oughtness of things, it raises the added question -- if a needed commodity is not within the reach of the people, what are the barriers which lie in the way? And how can they be removed? [ibid., p. 24].

The reference above to the "oughtness of things" indicates clearly that the problem under consideration was a normative question concerning the welfare effects of the prices and quantities of particular products. Hamilton contended that inquiry which was purposeful "has no quarrel with the most honest and thorough pursuit of knowledge" [Hamilton 1939, p. 527]. Hamilton's use of an explicitly normative question as the basis for his inquiry into price determination provides another illustration of his concern for making economics relevant to practical problems.

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[23]. For this his study of the bituminous coal industry must serve as the relevant example.

As he had done in The Control of Wages, Hamilton was addressing the question of price formation in terms of how it could be controlled. In order to address the problem in this manner, Hamilton felt compelled to refute the case against the control of prices. As he had done in regard to wages, Hamilton asserted that it was institutional factors that determine the prices of goods.

> The mark of accident, of custom, of conscious policy is upon every price. If in the pages below there are extended accounts of the sources of demand and the process of marketing, of the subtleties of technology and the intricacies of financial structure, it is because each of these matters has helped to shape the pattern of the industry and to fix the price of its ware. A myriad of conditions--which reaches beyond the confines of a continent and permeates the multiple aspects of a culture--lies back of the price of sugar, gloves, milk, an Oriental rug, a telegram, or a bit of junk to make it exactly what it is [ibid., pp. 25-6].

To focus on the mechanical workings of supply and demand to determine how prices come to be what they are was to miss the point, in Hamilton's estimation. The changing peculiarities of particular industries--advertising, taxes, quality, tastes, technology, credit terms, and concealed discounts, to list some of those mentioned by Hamilton--all went into making the price of a particular good what it was.[24] To the extent that these institutional

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[24]. At this point a defender of the neoclassical market model might well point out that Hamilton's institutional factors are already represented in the equations of supply and demand. But again, using the terminology of orthodox theory, these are treated in the neoclassical market model as exogenous variables, and thus

arrangements were subject to control, the price and quantity of a product would also be subject to control.

Unfortunately, Hamilton did not summarize his argument into a theory of prices analogous to "a theory of wages" [Hamilton 1968; rpt., chap. 10]. Rather, he went on to reject market competition as an adequate means of controlling price and output, and elaborate on the argument that institutional factors were a ubiquitous influence on the formation of prices. This gives Hamilton's remarks the appearance of being merely a critique of laissez faire ideology and conventional economic analysis. To a more orthodox economist these inquiries into the institutional characteristics of industry were not even considered economics.[25] However, using his remarks contrasting his approach to neoclassical price theory, it can be inferred that Hamilton had a theory of price, analogous to his theory of wages, that was based on the study of institutions as agencies of control.

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are not explained in terms of how they change or how they may be subject to control.

[25]. For example, see the review by Mund, American Economic Review, Dec. 1938, pp. 818-820. Hamilton retorted:

> if what we have done in Price and Price Policies is not economics, we are willing to call it by any name that is better. But we challenge the jurisdiction of any reviewer who professes economics as a science and practices it as a theology... [Hamilton 1939, pp. 105-6].

As an instrument of control, Hamilton found price competition lacking in several respects.

> As a guide to production, price has brought a huge surplus of capacity over market demand to bituminous coal, textiles, the building trades, steel, and cement. A flexible price has been unable to turn an advancing technology to effective use, has aggravated the host of the unemployed, and in its failure has created sources of further demoralization [Hamilton 1938, p. 547].

Hamilton's lack of faith in the market mechanism as a means of adjusting capacity and fostering the use of new production technology, can be traced to his studies of the war-time economy discussed above, and to his analysis of the bituminous coal industry, addressed below.[26] In short, according to Hamilton, the control exerted by market forces on price and productive capacity was said to be compromised by institutional arrangements impinging upon the operation of markets. This was not meant to suggest that perfectly competitive markets would, in the absence of other institutional factors, produce an ideal outcome. Rather, it was to insist that focusing upon market mechanisms in isolation from other institutions, did not provide an

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[26]. Hamilton's reference to "textiles, the building trades, steel, and cement" [Hamilton 1938, p. 547], probably indicate studies done under the auspices of the "Cabinet Committee on Price Policy" [ibid., p. viii]. It is not clear from the Preface to Price and Price Policies exactly what position Hamilton held on this committee. However, Hamilton indicates that "its domicile was shifted" for a time to the National Recovery Administration of which Hamilton was a member [ibid., p. ix].

adequate foundation for explaining such problems as excess productive capacity and unemployment.

In Price and Price Policies the non-market institutional factors that exert control over prices and productive capacity were referred to as industrial policies.[27] Hamilton defined industrial policy as follows:

> An industrial policy is an aggregate of the measures contrived for the guidance of industry by all the agencies which operate upon it. In each scheme of scattered control, discretion lies here and there. At various points the market, the investment banker, the trade association, the labor union, the legislature, and the judiciary obtrude to express their will, to set limits of tolerances, and to point a direction to development. In a continuous stream these multiple judgments diverge, converge, and take parallel courses; support each other and cancel out; and impress all they touch with a divided will [ibid., p. 528].

This statement reveals Hamilton's view of industrial policies as being the sum of all the institutions that influence the functioning of an industry. These included both public (legislative, judiciary) institutions, as well

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[27]. Recall that Dorfman titled the 1974 edited volume of Hamilton's work Industrial Policy and Institutionalism. The title may be somewhat misleading since the articles selected represent, in Dorfman's words: "the foundations of his economic theory," along with Hamilton's summary statement on "The Institutional Approach to Economic Theory" [Dorfman in Hamilton 1974, p. 25]. Hence, the reader seeking Hamilton's approach to industrial policy as applied to particular industries may be disappointed. It should become evident, however, that Hamilton's conception of industrial policy is integrally linked to the institutional approach.

as private (bankers, unions, trade associations) institutions.

Hamilton was making somewhat vague generalizations at this point, leaving the reader to find specific examples within the industry studies of the volume. Hamilton's purpose appears to have been to introduce the idea that industrial policies were always present, regardless of whether economists or politicians chose to see them as such. Viewing the price system as Hamilton did, as a complex of institutions that all exerted some measure of control, industrial policies were a readily apparent fact of economic system. Amidst this complex of institutions the market is seen as only one part--a part which cannot be understood except in relation to the many other parts making up the whole of the economic order.

Hence, to Hamilton, the choice was not between whether to "leave it to the market," or to impose control, but in what ways the market's control has already been compromised by the various, and often conflicting, industrial policies imposed by different agencies of control.[28] As Hamilton put it: "from authority it is too late now to effect an escape. The sovereignty of the market is past; the political controls are here and we must subdue them to the public interest as best we can" [ibid., p. 556]. It is not

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[28]. As will be seen below, this was the crux of Hamilton's analysis of the bituminous coal industry.

clear exactly what audience Hamilton was addressing with this remark. Because of Hamilton's service in the government during the New Deal era, it can be inferred that "we" were public policy officials. Thus, Hamilton's contention appears to be that the government needed to assume responsibility for the formation of industrial policies that served the public interest. However, while Hamilton saw the government as playing an important role in the formation of industrial policies, the government was not automatically seen as the preferred agency of control. For a more detailed illustration of Hamilton's analysis of industrial policies we must now turn to his studies of the bituminous coal industry.

## Bituminous Coal

Hamilton's institutional economic analysis of the bituminous coal industry was his most assiduous examination of a particular economic problem, that problem being the poor performance[29] of what was, at that time, the key energy producing industry in America. The task required two volumes: The Case of Bituminous Coal [Hamilton and Wright

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[29]. In the present context the term "performance" goes beyond the customary analysis of the price and quantity of coal produced in relation to the cost of production. Hamilton also considered such issues as the obsolete techniques being used in some mines, the varying quality of the coal sold to consumers, and the chronic surplus of labor in the coal industry.

1926] which provided a detailed description of influential institutions within and outside the coal industry, and A Way of Order for Bituminous Coal [Hamilton and Wright 1928] which speculated upon alternative policy measures.

As was typical of his style of exposition, Hamilton would blend a critique of the laissez faire position against non-market forms of control, with a description of the problem in institutional terms. Hamilton thus began his description of the problems facing the bituminous coal industry by comparing the actual organization and functioning of the industry to "the competitive ideal" of the orthodox market model.

Whereas the bituminous coal industry appeared to be competitive with respect to its concentration ratios and ease of entry [Hamilton 1926, pp. 40-42], its performance did not live up to the ideals that such a market structure is supposed to achieve. For example, with respect to labor, the "competitive ideal" meant that the wage rate paid by different firms in the industry should be equal. Moreover, this wage should be comparable to those in other industries with differentials for individual ability, occupational hazards, conditions of work and leisure, and so forth [ibid., pp. 33-36]. Hamilton found that these conditions did not apply to labor in bituminous coal.[30] Analogously, consumers paid different prices for coal which did not

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[30]. See below, pp. 103-4.

reflect differences in producer costs or the quality of the coal. Railroads were one group of consumers cited for being able to demand relatively low prices in exchange for preferential service, in this case circumventing regulations meant to provide equal rail access to producers [ibid., p. 69].

Hamilton's explanation for the divergence between the competitive ideal and the reality of the bituminous coal industry springs directly from his institutional approach to economics. Competitive markets were, within Hamilton's paradigm, nothing more than one of many possible institutional factors that may exert some measure of control.[31] For example, Hamilton asserted that within a mining firm organized as a corporate business structure, control may be exercised by a single majority owner, or where there is no dominant stockholder, a group of hired managers [ibid., p. 44]. Moreover, landowners might also able to exercise a measure of control when land was leased for mining operations.[32] In addition, investment bankers were said to be able to influence the selection of executive personnel [ibid., p. 45]. The essense of Hamilton's

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[31]. "For in spite of repeated assertions to the contrary there is nothing automatic or natural in any system of control. Free enterprise, no less than monopoly or government ownership, is a matter of human arrangements" [Hamilton and Wright 1926, p. 43].

[32]. Hamilton cited a Bureau of Mines study to claim that landlords had final approval of "the plan of the mining operation" [Hamilton 1926, p. 44].

argument was that control was not exercised by a single individual, free of conflicting goals, and able to maximize profits by following a simple set of decision rules as in the simple neoclassical market model.

Hamilton went on to argue that while self-interest serves as the sole guide to behavior in the market model, what appeared to rule the bituminous coal industry was a complex of motives going beyond, or even ignorant of profit maximization. Hamilton wrote: "it would be somewhat more accurate to say that custom and ignorance rule coal than to attribute its guidance to enlightened self-interest" [ibid., p. 45]. One observation used by Hamilton to support his conclusion was that factual information was often lacking, and when available, would not necessarily be utilized by the firms in bituminous coal mining for decision-making. Hamilton regarded the "dead hand of custom" as the typical substitute for profit maximizing behavior for individuals associated with the bituminous coal industry. This, according to Hamilton, explained many of the existing practices in the bituminous coal industry, practices that should not have existed were individuals behaving in the rational self-interested manner assumed in the neoclassical market model.

> It explains in large measure the prevalence of room and pillar mining, with comparatively few variations from the pattern of Civil War days. It explains the difference in the 'rights' of the workers from one district to the next. It

> explains many of the inequalities in the wage structure [ibid., p. 47].

This provides another illustration of Hamilton's use of a social psychology in which institutions, i.e., "the dead hand of custom," are the main influence upon human behavior.

The tendency toward combination in the coal industry was another example provided by Hamilton of the industry's divergence from the competitive market model. In keeping with his proposition that there is nothing inevitable or natural about any particular system of control, Hamilton observed the efforts of coal producers to organize themselves into trade associations and coal workers into unions, in both cases to find relief from the vagaries of the competitive market. Hamilton described the United Mine Workers (UMW) as the more successful attempt at combination in bituminous coal: where labor was represented by the UMW, the union exercised some degree of control over wage rates, the length of the working day and other working conditions [ibid., pp. 49-50].

Finally, Hamilton identified several other interests and institutional arrangements that exercised various aspects of control over the coal industry. These included the railroad and steel industries, and various governmental instruments of control: "federal anti-trust laws, and transportation acts, state corporation laws, investment and finance laws, labor laws, truck acts, state transportation laws," [ibid., p. 51] and an array of state mining laws.

Hamilton's conclusion regarding the organization of the bituminous coal industry was that "the compromises with free competition are almost as conspicuous as its resemblance to the [competitive] ideal" [ibid., p. 52]. This led Hamilton to coin the phrase "compromised control" [ibid., chap. 3]. This phrase was intended to describe the complex of institutional factors that controlled the production and distribution of bituminous coal. As discussed below, these included market forces. However, from the perspective of Hamilton's institutional approach to industry studies, markets, even those that exhibited aspects of the competitive "ideal," had to be described by their relation to other economic institutions that were relevant to the problem of control. Control was, therefore, "compromised" in the sense that there was not a single control mechanism, e.g. competitive markets, that guided production and pricing decisions toward a socially beneficial outcome.[33]

Having described the control of the bituminous coal industry as being "compromised" by those institutions that had influence over it, Hamilton also found that aspects of a competitive market structure, such as ease of entry into the industry, were present. Hamilton would hardly have called

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[33]. This was meant to invalidate the competitive market model as a useful analytical device with which to explain how the production and distribution of bituminous coal was organized. However, this should not to imply that Hamilton thought an unimpeded market is either possible or desirable.

this "workable competition," despite this evidence of a competitive industry structure. Instead he declared that, "[e]ven a hasty glance at bituminous mining as it is and has been shows more chaos in the elements than competition was supposed to tolerate" [ibid., p. 55]. One of the more serious problems was chronic excess capacity [ibid., pp. 57-58]. In the competitive market model the condition of free entry and exit means that firms will shut down and move capital out of an industry when it is no longer profitable to be there. However, in bituminous coal, Hamilton argued, this condition was asymmetrical with firms rushing in to reap occasionally high profits, but refusing to exit when realizing losses until they finally went bankrupt. Three possible reasons were given for the failure of capacity[34] to adjust. First, firms would be reluctant to halt production completely if it was more costly to close a mine than to continue operating it [ibid., p. 59]. For example, in some cases pumping operations had to be continued in order to prevent a mine from being permanently flooded, giving a somewhat new interpretation to the concept of "sunk

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[34]. Capacity was calculated by taking average daily output of mines operating during a given year and multiplying it by 308. As such it gives a rough measure of what the existing labor and capital equipment was capable of turning out were it operating on a regular schedule. Had a firm shut down a mine for the entire year it would then not have been counted as having any capacity. It can therefore be inferred that this is how Hamilton conceived of exit from the industry. Conversely, keeping a mine open on a reduced work schedule causes it to be counted as part of total industry capacity [Hamilton and Wright 1926, pp. 257-259].

costs." Hence, many firms would maintain limited production despite falling prices and mounting losses, conditions that call for exit from the industry in conventional theory.[35] Second, the introduction of new machinery tended to increase the capacity of existing mines [ibid., p. 60]. Third, bankruptcy failed to reduce industry capacity because a bankrupt firm's assets would be quickly purchased at bargain prices and the mine reopened, thereby maintaining the productive capacity of the industry [ibid., pp. 63-65]. Thus, although firms did exit in name, the mines remained as producing units under new ownership.[36]

The market had also failed to induce uniform productive efficiency between different mining operations in Hamilton's assessment. Reports on the costs of production were cited showing a range from $1.50 to $4.50 per ton which could not

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[35]. From the perspective of orthodox microeconomics it might be argued that the firm simply had not reached the minimum point on the average variable cost curve and therefore was acting quite rationally by not closing down production. However, Hamilton was utilizing J.M. Clark's concept of overhead costs in which labor cannot be readily cut back because of the need to maintain an immobile capital investment. See Hamilton's citation of Clark's Economics of Overhead Costs [Hamilton and Wright 1926, p. 60].

From a macroeconomic perspective, it might be said that producers were waiting for a cyclical upturn in the price of coal to restore profitability. The cyclical nature of coal prices were discussed by Hamilton in his remarks on "The Coal Cycle" [ibid., pp. 203-4].

[36]. Hamilton highlighted the speculative nature of investments in the bituminous coal industry when he wrote: "He [the investor] stood a gambler's chance of losing his all, winning vast wealth, or receiving a return not unlike the return his more cautious neighbors reaped from seasoned investments" [Hamilton and Wright 1926, p. 66].

be explained solely by variations in the quality of coal seams [ibid., pp. 62-63]. Hamilton's explanation was that the quality of mining practices varied widely, the "dead hand of custom" causing many firms to rely on outdated methods. Thus the "compromised control" exerted by unworkable competition had failed to induce firms to adopt the most economically efficient techniques of production.

Hamilton further asserted that the "compromised control" of the labor market in bituminous coal resulted in similar "chaos" for the mine workers. Irregular employment was the norm for most miners in that 700,000 workers were available to do the work which could be accomplished by 500,000, according to Hamilton's estimate [ibid., pp. 60-61]. Presumably Hamilton meant that 500,000 workers employed full-time for the entire year could have produced what 700,000 men produced with intermittent layoffs. "Even though 'firing' is an art little understood, and reduction of the working force in dull seasons is contrary to custom, few miners have an opportunity to work 300 days in the year" [ibid., p. 78]. According to Hamilton, mines would periodically close completely, or remain open working only "two or three days a week" [ibid.]. Despite a yearly income below the Bureau of Labor Statistics "minimum requirement of 'health and decency'" [ibid., p. 80], an amount that Hamilton argued did not compensate for the hazardous work

and poor living conditions in mining, workers refused to change occupations.[37]

Furthermore, Hamilton was not optimistic regarding the possibilities for improvements in the situation of mine workers given the extant institutional arrangements. While he saw the United Mine Workers as the miners' best means for improving their condition, the "prevailing drift" was toward increasing market share for non-union fields. The reasons for this included: first, the inability of firms in union fields to adjust wages downward[38] in periods of slack demand, making them less able to compete with non-union firms on price; second, the resistance of organized workers to the introduction of new machinery to lower costs, further weakening the ability of unionized firms to compete on price; and third, the fact that the coal in the non-union fields in the east was of better quality and lower cost--both to mine and transport--than that of the western mines

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[37]. Hamilton explained this fact in institutional terms as well: "'Once a miner, always a miner' expresses common recognition of this fact" [Hamilton and Wright 1926, p. 214]. The "fact" being the unwillingness of miners to make the transition to working in a factory.

[38]. Given Hamilton's assessment of the effects of lower wage rates following the demobilization of military personnel following World War I, it is safe to say that he was not advocating lower wages as a solution to unemployment in the unionized segment of the coal industry. His point is simply that relatively higher wages put union mines at a disadvantage relative to non-union mines. As will be discussed below, Hamilton advocated giving all workers in the bituminous coal industry a measure of control over wages and employment decisions.

dominated by the UMW, further enabling these firms to undercut the prices of their unionized rivals [ibid., p. 232]. These institutional factors combined to weaken what control the UMW might have otherwise provided workers with respect to wages and employment security.

Whereas The Case of Bituminous Coal was primarily a work of analysis, A Way of Order for Bituminous Coal, Hamilton and Wright's second volume on the subject, was concerned with "finding out and setting down ... a scheme of arrangements under which there is a reasonable chance of exacting from the industry a specific performance" [Hamilton 1928, p. 29]. The "specific performance" to which Hamilton referred was his assessment[39] of "[t]he ends of the industry" which were: first, "to furnish consumers with a regular supply of coal at the lowest real cost,..." and second, "to provide adequate livelihoods to the portion of the population dependent upon it for the means of life" [ibid., p. 41].[40]

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[39]. Other analysts, having more faith in the ability of private enterprise to achieve the best possible outcome for the bituminous coal industry, would focus more attention on the financial health of coal producing firms. See, for example, the exchange between Hamilton and Eugene V. Rostow in The Yale Law Journal, February 1941, especially Rostow's comments on p. 613.

[40]. Within Hamilton's paradigm neither the "real cost" of coal nor an "adequate livelihood" for miners could be determined without placing them in the context of the institutional setting which made them what they were. The "real cost" of coal was described as the "necessary cost of production," but what those costs were necessarily depended upon the prevailing arrangements in the industry--such as

Having specified the consumers of coal and the workers in the coal industry as the relevant interests, and the ends of the industry as being to make both parties better off in terms of lower prices and higher wages, the problem becomes one of devising new institutional arrangements to attain those ends. Hamilton reviewed the pros and cons of such arrangements as union control, nationalization and regulated monopoly. Each was cited by Hamilton as having flaws that could prevent bituminous coal from serving the ends he had specified. Union control, for example, would not necessarily have been in the best interest of consumers because higher wages could be realized by raising prices. To serve the interests of consumers and miners, control had to be exercised with the aim of increasing productive efficiency, and reducing the claims upon the income generated within the industry [ibid., pp. 106-111]. This would create a "surplus" in the sense of an unappropriated

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the ability of the industry to adjust mining capacity, the technical arts employed in mining, the ability of workers in the coal industry to organize themselves, and so on. Hamilton, therefore, asserted that the "real cost" of coal is not an "inflexible measure of pecuniary expense," [Hamilton and Wright 1928, p. 45] which can be derived by appeal to the mechanistic market model; instead it is an evolving standard which would be redefined by changing circumstances. Likewise, the definition of an "adequate livelihood" was an evolving standard because it too would change along with the habits and customs of society.

increment in real income that could be used to lower prices and provide higher wages.[41]

Hamilton then suggested the possibility of a "captive industry," an idea inspired by the British economist Henry Clay [ibid., p. 164 ff]. In this proposed institutional arrangement, the problem of "compromised control" would be eliminated by granting to a "national company" the "exclusive right to dispose of coal by primary sale" [ibid., p. 250].[42] Unlike a regulated monopoly supervised by a government agency, control would be exercised primarily by members of the relevant interest groups: the union (representing all the miners), and the largest consumers (e.g. steel and utilities). The new corporation would be financed by the exchange of existing equities for debentures.[43] Voting shares would be issued in the form

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41. The analogy to Hamilton's discussion of the "economic arts" in The Control of Wages should be apparent.

42. Firms that mine coal for their own use would be allowed to do so under "Federal license," and subject to strict regulation of health and safety standards, wages, and working conditions [Hamilton and Wright 1928, p. 250]. Other than this exception, all mining and marketing of bituminous coal would be under the control of a single national corporation.

43. This is done "upon the basis of an equivalence of values" [Hamilton 1928, p. 169]. The exact determination of the value of equities, and of other forms of compensation to displaced property owners, would itself be a complicated task requiring a large measure of judgement [ibid., pp. 232-235]. The acquisition of coal properties would be handled by an "interim commission" equipped with "coercive powers to secure a transfer of properties from private parties to the new company" [ibid., p. 251, 249].

of non-dividend paying common stock distributed evenly between union and consumers' representatives. The managers of the new firm would be hired from among the more competent personnel who previously ran the separate firms. Management would have a number of seats on the board of directors equal to each of the other parties. While management would not have had voting rights, according to Hamilton, they would have been available to provide whatever technical advice was needed [ibid., pp. 170-172].

The intention of Hamilton's scheme was at the same time to realize those economies available to a corporate monopoly and to distribute the gains to workers and consumers, i.e., to free the industry from the chaos brought about by a compromised form of control. Hamilton believed that, with the interests of both workers and consumers represented equally on the board of directors, little government supervision would be necessary for protecting the interests of either group. Furthermore, since the debentures would carry no voting rights property owners and investors would no longer exercise any form of control over coal mining operations. Most importantly, capacity would be under the control of a single corporate entity with mining operations managed according to principles of efficiency.

With the consolidation of the industry under the control of workers and consumers, any forthcoming improvements in efficiency could be used to lower prices and

improve wage rates.[44] Just how any surplus income would be divided would continue to depend on the outcome of negotiations between the two groups of voting directors.[45] However, with the power to negotiate evenly distributed between the two primary interest groups, the intention was to focus the attention of workers and consumers on improving the performance of the coal industry, as opposed to struggling over relative income shares. With respect to the workers' desire for higher wages, for example, Hamilton states:

> ...if from time to time, increments are to be added, they must be found. The making of wages, therefore, ceases to be a thing apart, and becomes a matter affected with an industrial interest; it is no longer a subject for occasional settlement, it is an aspect of a continuous process of policy making [ibid., p. 207].

Thus, to continue to raise wages the workers would have to concern themselves with measures to limit their numbers and

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[44]. It should be clear that Hamilton's attempt to find ways of creating a surplus income by reducing the income claims of property owners, improving the technique of coal mining, and restructuring the organization of the industry, is essentially the same process described in The Control of Wages. He is describing how to "find the increment" through the use of the industrial and economics arts.

[45]. Here the similarity to Commons' concept of "reasonable value" comes to the fore. As Ramstad puts it: "Commons worked to discover mechanisms that would place the power to decide equally in the hands of the principals who would have to be governed most directly by particular subsets of those rules" [Ramstad 1989, p. 768]. Given Hamilton's version of the Clay scheme, the determination of the "real cost" of coal in terms of an "adequate livelihood" for mine workers would be the result of a process similar to Commons' determination of "reasonable value."

to create an unappropriated surplus income through the introduction of new mining practices.

Despite all the detailed analysis that went into the argument for a "captive" bituminous coal industry, Hamilton made no claims that a new scheme of institutional arrangements could solve, once and for all, the industry's problems. Policy making in the real world is, as Hamilton put it, a matter of "choice and chance" [ibid., chap. 12].

> [T]he operation of any system compounded of human contrivances cannot escape the unknowns which lurk around the corner. The thing called certainty is far too unsure to make the most cunningly compounded system of arrangements more than a very inviting gamble. A judgment can have no other basis than a shrewd and knowing appraisal of the prospects and hazards of the several possible ventures. If in the matter of choice we would be moral, we must be shrewd and intelligent in placing our bets [ibid., p. 277].

Thus, Hamilton clearly saw institutional adjustment as an ongoing process. As circumstances changed, and as further analysis revealed the limitations of existing institutions, the need for new institutional modification would be revealed.

# CHAPTER 5

# THE INFLUENCE OF WALTON HAMILTON'S INSTITUTIONAL ECONOMICS

## Introduction

This chapter will assess the influence of Hamilton's institutional economics upon the development of economic theory, specifically institutional economic theory. A review of extant writings concerning Hamilton suggest that he was a key figure in the development of institutional economic theory. For example, it has been said of Hamilton that he was at one time the "acknowledged leader" of the "American institutionalist school" [Breit and Culbertson 1976, p.11], and that he "should be credited with having played the role of chief promoter" [Dorfman in Hamilton 1974, p. 28] of the effort to reconstruct economic theory along the lines of an institutional approach to the subject. Furthermore, the term "institutional economics," that Hamilton popularized with his presentation and publication of "The Institutional Approach to Economic Theory" [Hamilton 1919] is still widely used today.[1] Hamilton has also been

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[1]. As Walter C. Neale recently stated: "The words institution and institutional are central to institutionalist theory. Not only does the root word give us our name, but also and importantly it and its cognates run through our writings" [Neale 1987, p. 1177].

credited with having generated "a stream of highly capable students" [Dorfman 1969, v.5, p. 437],[2] and with having inspired Clarence Ayres to become a leading exponent of institutional economics [Ayres 1961, p. 28].

On the basis of the aforementioned observations, it would appear that Hamilton was a pivotal figure in the history of institutional economics. However, a more detailed examination of Hamilton's role in the development of institutional economic theory is needed in order to explain why his work has been given so little attention by historians of economic thought, especially modern-day historians of institutional economic thought.

Much of the neglect of Hamilton's contribution to economics, can be traced to the customary association between "institutional economics" and the economics of Thorstein Veblen, and to the notion that Hamilton was merely one of Veblen's disciples.[3] Because Hamilton's "Institutional Approach" became synonymous with Veblen's

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[2]. According to Dorfman Hamilton's students at Amherst included,

> Morris A. Copeland, Carter Goodrich, Dexter Keezer, Stacy May, Winfield W. Riefler, and Willard Thorp. Hamilton's students at Brookings included Mordecai J. B. Ezekiel, Paul T. Homan, Isador Lubin, George W Terbourgh, Woodlief Thomas [Dorfman 1969, v.5, p. 437fn.].

[3]. Examples of the interpretation that Veblen was the founding father of "institutional economics" were provided in Chapter 1, pp. 2-3. An interpretation of Hamilton as a disciple of Veblen is cited below, pp. 118-119.

evolutionary economics, it followed that Hamilton's work received little attention in the history of American heterodox economics.[4] However, the association of "institutional economics" with the economics of Veblen, and the subsequent lack of recognition of Hamilton's contribution to economic theory, is largely the result of a superficial interpretation of Hamilton's work.

Clearly Hamilton was not merely a disciple of Veblen's. As indicated in Chapter 2, it was Charles H. Cooley, not Veblen, who provided the primary inspiration for Hamilton's version of institutional economics. Moreover, as Hamilton stated in his review of Veblen's The Place of Science in Modern Civilization [Veblen 1919], there was "a tendency to make [Veblen] responsible for all that is new in economics; and in history and psychology as well...." [Hamilton quoted in Dorfman 1972, p. 448]. Although this statement was not directed specifically at interpretations of his work, it clearly implies that shortly after publishing his "Institutional Approach to Economic Theory" [1919], Hamilton was of the opinion that new developments in economics were too often attributed to Veblen. Finally, Joseph Dorfman

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[4]. Joseph Dorfman, as editor of Wesley Mitchell's Types of Economic Theory [Mitchell 1969], noted that in 1914 Mitchell labeled Veblen's type of economics "evolutionary," and later (1926-1927) began referring to Veblen's economics as "institutional" [ibid., p. 452fn.]. The title of the chapter on Veblen became "Thorstein Veblen's Institutional Approach" [ibid., chap. 20]. Hamilton does not receive any recognition in that chapter for coining the term "Institutional Approach," or "institutional economics."

stated that on the copy of The Politics of Industry [Hamilton 1957] given to him by Hamilton, the latter had inscribed: "As one Veblenian to another, Veblen, you know, did not want mere disciples" [Dorfman in Hamilton 1974, p. 24fn, emphasis added]. Hence, while Hamilton apparently considered himself "Veblenian" as late as 1957, he did not see himself as a "mere disciple." As Dorfman pointed out, Hamilton had dedicated The Politics of Industry to the memory of his teachers at The University of Michigan, including Cooley, "each intent upon his own trail, all willing for me to take my own" [Hamilton 1957, n.p., emphasis added]. Dorfman was clearly implying that his friend Hamilton, whom he described as "a social philosopher,... gifted writer, conversationalist and teacher,... economist, political scientist, legal scholar and expert on the administrative functions of the national government" [Dorfman in Hamilton 1974, p. 5], was not a mere disciple of Veblen's.

The estimation of Hamilton as a disciple of Veblen's will be shown to have, first, reduced the impact of Hamilton's "Institutional Approach," not only by identifying "institutional economics" with Veblen, but by having contributed to the failure of Hamilton's ambitious plan to unify the "protestants" into "a common enterprise" [Hamilton 1918c, pp. 404-5] that would supplant neoclassical economic

theory.[5] Second, even though Clarence Ayres's interpreted Hamilton's institutional economics as Veblenian economics, he took his economic theory in a somewhat different direction than that of Hamilton. This meant that Ayres, who became a leading "institutional" economist, would have few occasions to recognize Hamilton's positive contributions to institutional economics.

## The Failure to Unify the Protestants

Allan Gruchy remarked that several American heterodox economists of the 1920's rejected "institutional economics" as the designation of their approach to economic theory. Gruchy cited the proliferation of alternative titles, such as Wesley C. Mitchell's "quantitative economics," J.M. Clark's "social economics," and Rexford Tugwell's "experimental economics" [Gruchy 1947, p. 3], as evidence. Gruchy went on to argue that it was the "holistic"[6] method

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[5]. As noted in Chapter 3, Joseph Dorfman indicates that Hamilton was a key figure in a movement towards "permanent reclamation of the American Economic Association" by the non-neoclassical economists [Dorfman in Hamilton 1974, p. 27]. Hamilton's presentation of "The Institutional Approach to Economic Theory" [1919] at the December (1918) meeting of the American Economics Association, was part of that effort.

[6]. To Gruchy a holistic method is also "evolutionary or dynamic rather than mechanistic or static...." [Gruchy 1947, p. 4]. Hence, a holist would view an "economic system to be an evolving process or going concern any one part of which is to be fully explained only in the light of its relations to the whole dynamic economic complex" [ibid., p.

that these various heterodox economists had in common, as opposed to the "institutional economics" associated with Veblen[7] [ibid., pp. 4-5].

J. M. Clark's "social economics" was a striking example in this regard because Clark had collaborated closely with Hamilton in the "movement for reconstruction of economics" [Dorfman in Hamilton 1974, pp. 25-28]. Clark presented "Economic Theory in an Era of Readjustment" [Clark 1919] at the same session of the 1918 meeting of the American Economic Association during which Hamilton presented his "Institutional Approach to Economic Theory" [Hamilton 1919]. At the time, Clark did not explicitly identify himself as an institutional economist, instead using "social economics" as the designation of his approach [Clark 1919, p. 281]. Nonetheless, there were several areas of convergence between Clark's "social economics" and Hamilton's "institutional economics." In the discussion which followed the presentation of the Hamilton and Clark papers, Clark explicitly described the method he was advocating in

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5]. Terms such as "organic," "social process," "genetic," "evolutionary," "post-Darwinian," and "holistic" are all used to describe essentially the same general approach toward economic phenomena.

7. J. R. Commons' Institutional Economics [1934], appears to be an exception. However, as Gruchy pointed out, Commons used terms like "collective action," "volitional," "investigational," more frequently than "institutional" [Gruchy 1947, p. 3]. It should also be noted Hamilton received only a single citation in Institutional Economics regarding his article on "Property According to Locke" [Commons 1990; rpt., p. 40].

"Economic Theory in an Era of Readjustment" as being the same as that which Hamilton had offered in "The Institutional Approach."

> Professor [B. M.] Anderson, [Jr.], says that Professor Hamilton and myself have not produced anything that gives a sample of the method we advocate sufficient to justify the stand we have taken [Clark 1919, pp. 323-324, emphasis added].

These remarks, taken alone, would only tend to validate Gruchy's point that it was an interest in alternative methods that American heterodox economists had in common. However, in Readings in the Economics of War [Clark 1918] Clark joined with Hamilton and Harold Moulton in advocating the study of institutions for the purpose of devising ways of controlling the development of the economic system.[8] Clark's interest in institutions as instruments of control is also obvious from the titles of his books, The Social Control of Business [Clark 1926], and Economic Institutions and Human Welfare [Clark 1957]. Clark once described the objective of his work as the pursuit of a "social-institutional-dynamic economic theory" [Clark quoted in Dorfman 1969, v.5, p. 438]. Furthermore, Clark explicitly acknowledged the influence of Hamilton's mentor Charles H. Cooley upon his work. Specifically, Cooley contributed to

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[8]. This is discussed in Chapter 4 under "An Economic Analysis of World War I."

Clark's social psychology, and his view of institutions as instruments of social welfare.[9]

> Charles H. Cooley performed the <u>great service</u> of showing that the mechanism of the market, which dominates the values that purport to be economic, is not a mere mechanism for neutral recording of people's preferences, but a social <u>institution</u> with biases of its own, different from the biases of the <u>institutions</u> that purport to record, for example, aesthetic or ethical valuations [Clark 1957, p. 57, emphasis added].

In short, Clark's "social economics" had more in common with Hamilton's "institutional economics" than a general interest in holistic methods.[10]

Clark's preference for the term "social economics" may be interpreted as a reflection of a somewhat different emphasis, or merely as a vain attempt to distinguish his approach from other alternatives to neoclassical orthodoxy. Gruchy's interpretation, however, was that younger members of the American heterodox movement, Clark being one example, chose not to call their work "institutional economics," because the name was associated with "Veblen's disciples"

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[9]. Clark dedicated his <u>Alternatives to Serfdom</u> [1948] to Cooley. On this and other references by Clark to Cooley, see [Dorfman 1969, v.5, p. 440]. Note also that Dorfman stated in an editorial footnote that both "Clark and Hamilton were influenced especially by Veblen <u>and</u> Cooley" [Mitchell 1969, p. 452fn., emphasis added].

[10]. Clark was of the opinion that the title "institutional economics" did not represent a unified group of American heterodox economists. Clark stated that, "[t]he term 'institutionalism' has been applied to a number of such [heterodox] theories, some having little in common except departure from 'marginalist' orthodoxy" [Clark 1957, pp. 56-57].

[Gruchy 1947, p. 2]. Gruchy asserted that the "new members of the group," who rejected the title of "institutional economics," were influenced only indirectly by Veblen and that they were "more concerned with immediate economic and social issues than was Veblen," and found "various parts of the Veblenian interpretation somewhat outmoded" [ibid., p. 2]. It is significant that Gruchy counted Hamilton among the "disciples" of Veblen rather than one of the "[y]ounger exponents of economic heterodoxy, such as John M. Clark" [ibid., pp. 2-3]. Clearly Hamilton could have been placed in the same category as Clark.[11]

To the extent that Gruchy's interpretation was representative of prevailing opinion,[12] it can be said that Hamilton's "Institutional Approach" was viewed as Veblenian economics, and that Hamilton's attempt to unify the "protestants" failed in part because of this association between "institutional economics" and Veblen. It is clear, however, that it was not Hamilton's intention merely to give a new name to Veblen's economics. On the contrary, Hamilton believed that the "various groups" of heterodox economists he called "protestants," were "mere aspects of a single

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[11]. This should become more evident as the distinction between what I call the Cooley-Hamilton model of institutional economics, and the Veblen-Ayres model, is illustrated below.

[12]. Given the interpretation of Hamilton's institutional economics by Ayres, and others noted below, it is evident that Gruchy's impressions were not unique.

general intellectual movement" [Hamilton 1918b, p. 404, emphasis added]. Hamilton explicitly stated that institutional economic theory should draw on the work of a number of economists, Veblen being only one of the twenty mentioned by name [Hamilton 1919a, p. 318]. Hence, although it is impossible to know how Hamilton would have been regarded had his "Institutional Approach" been interpreted as a paradigm[13] for a general heterodox movement, there is reason to believe that the association of "institutional economics" with Veblen diminished the chances for Hamilton to unify that intellectual movement.

## Hamilton's Influence Upon Clarence Ayres

It can be said that Hamilton's most enduring influence upon the development of institutional economic theory was in having inspired his "protege," Clarence Ayres, to become "the chief exemplar" of institutional economics [Breit and Culbertson 1976, p. 5]. Thus, Ayres's work presents itself as another means through which Hamilton could have been recognized for having a major impact on the development of institutional economic theory. Therefore, an examination of Hamilton's influence upon Ayres is necessary in order to more fully explain the neglect of Hamilton's contributions

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[13]. Once again I remind the reader that I am using "paradigm" in its generic meaning.

to institutional economics among modern-day institutional economists.

The influence of Hamilton upon Ayres began during the time the two were colleagues at Amherst College. Ayres served as an assistant in Hamilton's course on social and economic institutions at Amherst. It was during this time that Ayres reached a turning point in his own intellectual life with regard to his understanding of economic theory. Ayres recounted this event as follows:

> I began to wonder when [Hamilton] was going to get around to unfolding to these freshmen such basic ideas as 'marginal utility.' Finally I mustered up my courage to ask him, and through the forty-four years that have since elapsed I have never forgotten the gleam of amusement in his eyes as he replied, 'I'd do so at once if only I understood them myself!' Like Henny-Penny, I felt the heavens falling, for already I had conceived a tremendous admiration for the mental processes of this extraordinary young professor. Could it be that all the elaborate analytical apparatus of marginal analysis was actually without meaning? It could [Ayres 1961, p. 28].

Ayres went on to credit Hamilton with having taught him that Veblen's criticism of orthodox economic theory was intended to show that the economic system was "regulated by the institutional structure of Western society, of which the market is at most only a manifestation" [ibid.].[14] Taken at face value, these remarks clearly indicate that Walton

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[14]. It is interesting that Ayres was describing Hamilton interpreting Veblen, while the passage quoted could just as easily be taken as an interpretation of Cooley's view of the institution of the market. See for example footnote 9 and Chapter 2.

Hamilton was the instrument of Ayres's conversion to institutional economics.

Hamilton further influenced the course of Ayres career as an economist when, less than half-way through his career Hamilton essentially left the discipline of economics to teach and write about legal institutions. According to Talcott Parsons, "when he joined the faculty of the Yale University Law School [in 1928], [Hamilton] transferred out of [economics] into a certain kind of amalgam of social science and law" [Parsons 1976, p. 176]. This event, along with Hamilton's service in Roosevelt's Brain Trust in the 1930s, meant that the "American institutionalist school had lost its acknowledged intellectual leader" [Breit 1976, p. 11]. This position of intellectual leadership left open by Hamilton was filled by Clarence Ayres. According to Breit and Culbertson, after Hamilton had taken a position on the faculty at Yale Law School, "Ayres made up his mind that his own mission would be to 'identify the philosophical parameters of Walton Hamilton's Institutionalism'" because "none of [Hamilton's] writing contained the definitive revelation for which Ayres had fervently hoped" [Breit and Culbertson 1976, p.7]. To the extent that Ayres was actually interested in further developing Hamilton's theoretical approach to institutional economics, one would expect there to be numerous references by Ayres to Hamilton's writings. However, the dearth of citation to

Hamilton on the part of Ayres, as well as Ayres's criticism of Hamilton's choice of "institutional economics" as a title, suggests that what the latter actually identified were not the philosophical parameters of Hamilton's economic theory.

Ayres was among those who believed that institutional economists, Hamilton in particular, found their common inspiration in the work of Thorstein Veblen. Ayres stated his view of the "protestants" in 1938 as follows:

> no critical consensus has evolved [among heterodox economists], and no new Wealth of Nations has appeared. Perhaps the 'Institutionalists' have more in common than most other protestants. At least they acknowledge Veblen as a common source of inspiration [Ayres 1938, p. iii; emphasis added].

At a later date Ayres would assert that Veblen did not use the term "institutionalism," and that it was actually "a misnomer" [Ayres 1952, p. 25].[15] These remarks imply that Hamilton had misinterpreted Veblen's work when the former chose the title of "institutional economics." However, Ayres's interpretation would appear to have resulted from his belief that it was primarily Veblen's influence that "led Walton Hamilton to identify himself and other like-minded persons (in particular, Robert Hoxie) as 'institutionalists',..." [Ayres 1952, p. 25]. This, along

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[15]. Ayres was not alone in this opinion. John Gambs had made a similar argument stating that institutional economics was not "institutional" and that Veblen would likely have chosen "evolutionary" as a title [Gambs 1946, p. 9].

with Ayres's statement that "'institutionalism' has now been employed for more than a generation to refer to the way of thinking which stems from Veblen" [ibid., p. 26], suggests that he had little regard for Cooley's contribution to Hamilton's institutional economics.[16]

Because there exist numerous similarities between Veblen's and Cooley's approach to the subject of economic theory--the common interest in evolutionary methods being only the most obvious--it might seem that the point is trivial. However, the purpose of exploring the differences in the sources and nature of institutional economics, as it was elucidated by Ayres and Hamilton, is to help to explain why Clarence Ayres so seldom referred to the work of the individual who inspired him to pursue the development of institutional economics.[17] More generally, this will help

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[16]. As previously noted, Hamilton stated that there was "a tendency to make [Veblen] responsible for all that is new in economics; and in history and psychology as well...." [Hamilton quoted in Dorfman 1972; rpt., p. 448]. Of course Hamilton was not speaking of Ayres in particular, but the statement seems strangely prescient in light of Ayres's view of the "protestants."

[17]. As already pointed out, Ayres did refer to Hamilton as the inspiration for his conversion to an institutionalist way of thinking about economics. Ayres also referred to Hamilton's article on "Institutions" as "must" reading for those interested in institutional economics [Ayres 1952, p. 423]. However, conspicuously absent is any reference by Ayres to Hamilton's "The Institutional Approach to Economic Theory" [Hamilton 1919], or any of his policy oriented works.

to illustrate that Cooley and Hamilton made original contributions to institutional economic theory.[18]

Specifically, it is argued that Ayres utilized a Veblenian interpretation of the nature and function of institutions that caused him to give his institutional economic theory a different character from that of Hamilton. What I will call the Cooley-Hamilton model of institutional economics can be distinguished from its Veblen-Ayres counterpart by the former's emphasis upon institutions as changeable mechanisms of social control that may be consciously altered to enhance social welfare, and the latter's emphasis on institutions as antiquated patterns of behavior which change under the onslaught of technological change.

J. M. Clark hinted at the nature of this distinction in his remarks on the heterogeneous character of "Institutional Theory" [Clark 1957, pp. 56-58]. As evidence of the diversity in institutional theory, Clark contrasted the work of Cooley and Veblen:

> Policy-wise, [Cooley's] theories looked largely in the direction of making the market responsive to a more representative selection of the values actually prevalent in the society.
>
> By way of contrast, Thorstein Veblen combined a merciless deflation of the pretensions of the business system with an Olympian detachment from

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[18]. Different interpretations of Veblen's and Ayres's work could be offered if emphasis were to be placed on the many obvious similarities between the Cooley-Hamilton model of institutional economics and that of Veblen-Ayres.

> questions of what to do about it... His whole bent was against making purposive recommendations [Clark 1957, p. 57].[19]

This distinction between Cooley's policy-oriented theory and Veblen's "Olympian detachment" from questions of policy may itself be explained largely by their differing views on the function of institutions and the way they change. These differing views on the function of institutions and process of institutional change were, in turn, incorporated into the respective works of Hamilton and Ayres. Hence, it is useful to explore this distinction in more detail.

In "The Evolution of the Veblenian Dichotomy" [Waller 1982] William Waller makes the argument that Hamilton's concept of institutions differed from Veblen's usage of that term in two important aspects. First, according to Waller, Veblen saw institutions as "a non-dynamic factor in cultural development" [ibid., p. 761]. Institutions were to Veblen essentially a static element of the cultural environment that are altered only under the force of "changing technological circumstances" [ibid.]. In contrast, Hamilton "allows for the possibility that change in the institution is a cause of change in the outside circumstances" [ibid.]

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[19]. An exception to Veblen's detachment from policy issues came in The Engineer's and Price System [Veblen 1983; rpt.]. According to Daniel Bell "Walton Hamilton felt that as a journalist Veblen the agitator and phrase-maker was taking precedence over the thinker" [Bell in Veblen 1983; rpt., pp. 13-14]. Taken at face value this remark suggests that Veblen's foray into policy matters was not viewed by Hamilton as part of Veblen's contribution to economic theory.

while Hamilton also recognized that institutions may be resistant to change. Hence, to Hamilton there were two aspects to the nature of institutions; they are "'always new yet ever old, directive and responsive, a spur to and a check upon change, a creature of means and a master of ends'."[20]

Hamilton's view of institutions as being either backward or progressive can be attributed largely to the influence of Cooley. To Cooley aspects of human behavior which arise from,

> particular situations and institutions... may be selfish, inefficient, quarrelsome, conservative now, and a few years hence or in another situation generous, peaceful, efficient, and progressive; all turns upon how it is evoked and organized [Cooley 1964;rpt., p. 33, emphasis added].

Utilizing Cooley's social psychology Hamilton stated that "an acceptable theory of human behavior" would find "the chief source of differences in the content of [human] behavior" to be in the "variety of institutional situations impinging upon individuals" [Hamilton 1919a, p. 316]. Because institutions are changeable, or "in process of development," then it followed in Hamilton's opinion, that "they are subject to conscious control" [ibid., p. 316] for

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[20]. Hamilton quoted in Waller 1982, p. 762, emphasis is Waller's. The quotation is from Hamilton's article on "Institutions" [Hamilton 1932]. As previously noted, Ayres believed "Institutions" was essential reading. Apparently Ayres gave Hamilton's article a different interpretation from Waller.

the purpose of directing the course of economic development and enhancing social welfare.[21]

According to Waller, the "second crucial difference between Hamilton's and Veblen's concept of an institution [is] illustrated by Hamilton's statement: 'Moreover the way of knowledge is itself an institution'" [Waller 1982, p. 762]. What makes this a "crucial difference" to Waller is that Veblen has often been interpreted--whether rightly or wrongly is not to be determined here--as distinguishing technological behavior from institutional behavior by attributing the process of acquiring and using knowledge exclusively to technological behavior.[22] In contrast, according to Waller, Hamilton allows for both types of behavior to be exhibited within institutional arrangements.

This interpretation is consistent with Hamilton's institutional approach to economic theory. For example, in The Control of Wages [Hamilton and May 1968; rpt.] Hamilton made the point that the development of modern technology had

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[21]. Hamilton had elsewhere stated that "welfare fixes the end" [Hamilton 1918b, p. 404] for which institutions are the instruments for exercising control as a means to that end. Although Hamilton does not explicitly cite Cooley as the source of this notion, Cooley did state that social science should also be an "ethical science" and that the "deepest responsibility" of a social science was in "functioning in aid of general progress" [Cooley 1969; rpt., p. 258].

[22]. As we will see below, this is an idea on which Ayres elaborated in some detail.

become subject to control with the use of institutional arrangements.

> The more fundamental work of scientific discovery is carried on by research 'staffs,' connected with universities or foundations and manned with a personnel who are paid fixed salaries and whose primary 'incentives' are curiosity and scientific reputation [ibid., p. 57].

Here it can be seen that Hamilton had delineated a specific type of institutional structure--the university--which, like all institutions, has the "function... to set a pattern of behavior and to fix a zone of tolerance for an activity or a complement of activities" [Hamilton 1932, p. 185]. In this case the "pattern of behavior" is the fostering of "scientific discovery" or the development of technology. In this way human behavior, as directed by an institution, may be categorized as what Veblen would have called "technological behavior... the dynamic aspect of culture" [Waller 1982, p. 762]. Because the "development of the technique of industry" [Hamilton and May 1923, p. 56] may be the source of an increase in the output of goods, and in turn, an increase in real wages for workers, universities and other research institutions become factors to be examined in the quest to find ways to <u>control</u> wages. Hamilton went on to advocate the use of collective research institutions for developing the techniques of industry [Hamilton and May 1968; rpt., p. 72-73].

From the examples cited above, it is obvious that there is a basis for Waller's interpretation that Hamilton's and

Veblen's "concepts of institution are fundamentally different" [Waller 1982, p. 762]. Had Hamilton emphasized Veblen's concept of institutions as a retardant to social change, it would not have made sense for him to stress the use of institutions as instruments of progressive social change. It follows, moreover, that had Hamilton been working with a concept of institutions as predominantly static, he would not have placed as much importance upon idea that the development of the economic system could be controlled through the conscious alteration of institutions. Veblen's appearance of "Olympian detachment" from questions of economic policy, in contrast to Cooley's overt interest in such questions, stemmed from his different focus. As Waller also notes, Veblen's concept of institutions was "part of an analysis of behavior on a cultural level" [ibid., p. 760], and at that level discussion of policy formation does not play a major part.

It is clear that Hamilton believed that the study of institutions was central to economic theory given his view that the purpose of economic theory was to address the problem of the control of economic development. With a sufficient understanding of social institutions, how they change, and how they affect human behavior, it would be possible to conceive of institutional arrangements that would serve as means toward socially desirable ends. In other words, contrary to Ayres's assertion, the title of

"institutional economics" was not a "misnomer" so far as one is speaking of Hamilton's economic theory.

Using Veblen as one of his main sources of inspiration, Ayres emphasized the static aspect of institutions while he viewed "technology" (see Waller for the confusion that surrounds the use of this term) as the progressive facet of culture. Ayres did agree with Hamilton that institutions had a controlling function with respect to human behavior.

> One peculiar feature which the 'typical' institutions all seem to exhibit is that of the determination of authority.... institutional authority is authority defined and supported and limited by custom [Ayres 1952, p. 43].

However, in the work of Ayres, the negative consequences of authoritarian control exercised through institutions received major emphasis. Institutions were primarily regarded as "ceremonial" in the sense that their function is to maintain the rank and status of individuals and groups within society. Moreover, institutions are not accurately understood or described as reasoned or conscious activity of individuals; the force of myth and emotional belief involved in their creation also received emphasis:

> All the typical institutions derive from a legend-enshrouded past,... institutions such as these were not set up; they 'just growed',... <u>the setting-up process itself is not an act of reason and organizational skill</u>. It is a ceremonial process.... All the affairs of all the typical institutions are conducted by ceremonial process. What is determined by all the rank relationships which institutions define is the ceremonial adequacy, as Thorstein Veblen called it, of the various participants [Ayres 1952, pp. 44-46, emphasis added].

Furthermore, because Ayres conceived of institutions as the product of the past, serving to justify arbitrary patterns of authority as well as to serve present exigencies, they act to inhibit progressive social change.

> In the process of social change the institutional function is essentially static. In the process of social change the institutional function plays a negative part. It resists change... For institutional behavior is peculiarly past-binding. The mores derive their authority from the past [ibid., p. 49].

Hence, the control which institutions exercised over economic activity, in Ayres's framework of analysis, was not described primarily as a tool for progressive social change, but primarily as an obstacle to such change.

On the other side of Ayres's dichotomy was technology; tool-using knowledge which represents problem-solving contributions made to the provisioning process of the economic system. For Ayres, the progress of technology allowed for control over the provisioning process, providing real economic security, in contrast to the imagined security found in ceremonial behavior [Ayres 1961, chap. 13]. However, as Ayres conceived the process of technological change, it occurs in interaction with and in spite of the existence of institutions, not because of them. New technology threatens the status quo built upon a foundation of static institutions. As Ayres put it:

> In short, technology is a dynamic force.... In the first place, invention and discovery are continually creating new areas of human activity in which--because they are new--the ancient

> institutions have comparatively little place.... As the social structure expands and stretches, cracks develop through which technological ways of thinking and organizing intrude upon regions which were predominantly institutional before.... Technology is dynamic, but institutions are static. The two forces oppose each other, and we have no reason to suppose that either one will invariably prevail [Ayres 1952, pp. 58-9].

Moreover, because Ayres described the process technological change as a process of combining existing tool-using knowledge the emphasis is not on individual rationality or genius.

> These combinations are physical not less than ideational. To be sure they are achieved by men, usually by men of great ability. But the things they put together are physical objects. The coexistence of these objects constitutes a possibility of combination which transcends the acts of any individual [Ayres 1978, p. 115, emphasis added].

This helps to illustrate why Ayres's theory of social change can be interpreted as a battle between "autonomous social forces"[23] that appears to leave conscious individual activity, and therefore conscious control, largely out of the picture. This also points towards an important difference in emphasis between Hamilton's and Ayres's theories of human nature and behavior.

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[23]. This is Malcolm Rutherford's interpretation of the holistic approach in the "Veblen/Ayres tradition" [Rutherford 1989, p. 314]. Rutherford goes on to argue that those who continue to work in this tradition, specifically Wendell Gordon, continue to view technological progress as "being only marginally affected by the prevailing institutions" [ibid.].

As discussed previously, the "modern social psychology" Hamilton derived from Cooley, bases human behavior on both a common human nature of biological origin, and the influence of the social environment that is manifested in institutions. Significantly, in the Cooley-Hamilton holistic ("organic") model "'the individual' and 'society' [are] remaking each other in an endless process of change" [Hamilton 1929, p. 185]. With this emphasis upon the ability of individuals to remake society Hamilton was in a position to stress the possibility of controlling the development of the economic order through the conscious alteration of institutions.

Ayres also saw a common human nature derived from a biological inheritance, with differences in human behavior being explained by differences in social environments.[24] However, in contrast with the Cooley-Hamilton social psychology, Ayres went on to emphasize the dichotomy between two aspects of human behavior--the ceremonial (institutional) and instrumental (or technological) aspects--each of these aspects of behavior being somewhat at odds with the other.[25] In dealing with the instrumental side of

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[24]. According to Hans Jensen, for "Ayres, there are two routes for the transmission of human nature: the biological route and the socio-cultural route" [Jensen 1987, p. 1055].

[25]. There is a certain schizophrenic quality to Ayres dichotomization of human behavior. "Individual scientists may behave like bullroarers outside the laboratory,..." [Ayres 1978, p. 184] while what they do inside the

human nature, Ayres played down the role of the individual. "Technological ways of thinking and organizing intrude" upon institutionalized behavior [Ayres 1952, pp. 58-59]. Hence, using Ayres's framework one less likely to view individuals as consciously engaging in instrumental behavior in order to change their institutional environment. Rather, individuals tend to be seen as passively awaiting the onslaught of,

> advances in science and technology that are so rapid and pervasive that more and more people become increasingly occupied, in thinking and doing, in activities that are devoid of ceremonial and mythological contents [Jensen 1987, p. 1960].

As previously pointed out, the process of discovery in science and technology was described by Ayres as resulting from an inevitable combination of pre-existing ideas, making the actions of particular individuals appear irrelevant, and the prospect of conscious control improbable.

The differentiation to be emphasized is that the Veblen-Ayres model of social change suggests two autonomous social forces remaking society, while the Cooley-Hamilton model more clearly places individuals in a position to consciously initiate changes in their institutional environment.[26] Furthermore, the Cooley-Hamilton holistic

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laboratory illustrates the process of how all "truth" and "value" is revealed [ibid., p. 220ff.].

[26]. In light of Hamilton's public service, it can be inferred that he saw the individual's role as influencing public policy. Of course collective decision-making limits the influence of any particular individual. Hamilton's approach, in my view, fits somewhere between the "new institutionalist" view of "institutions that are far too

model suggests a role for economists and public officials, to alter the course of economic development--address the problem of control--in a way that the Veblen-Ayres model does not. Instrumental behavior exhibited by individuals, in Hamilton's institutional economics, is proactive as opposed to passive. For Ayres, on the other hand, the seeming irrelevance of particular scientists in the process of scientific discovery, could logically extend to any particular economist or public official who believes that the process of institutional change can be controlled and directed towards particular ends. As Ayres put it: "The power which ideas exert by virtue of being correct is a function not of mind over matter but of technology over institutions in the long-run process of social change" [Ayres 1978, p. 289, emphasis added]. Ayres's point appears to be that the economist, as social engineer, must bide his time, hoping for the struggle between the forces of technology and institutions to validate and give effect to his ideas.[27] This gives the impression that attempts by economists to consciously remake the institutions of the economic order--address the problem of control--are futile,

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responsive to individual choice" and the Veblen-Ayres view of institutions changing as a result of an "outside, supraindividual, 'power'" [Rutherford, 1989, p. 314].

[27]. Ayres used "Mr. Keynes... judgement of the economic consequences of the Treaty of Versailles,..." [Ayres 1978, p. 287] as an example of the impotence of good ideas.

as it is the autonomous force of technological change that overcomes institutional resistance, and not the conscious effort of individuals to use institutions instrumentally.

Ayres's concept of the dichotomy between technological and institutional ways of thinking led him to state:

> As a designation of a way of thinking in economics the term 'institutionalism' is singularly unfortunate, since it points only at that from which an escape is being sought [Ayres 1962; rpt., p. 155n].

In using the term institutions Ayres emphasized ceremonial behavior, which helps explain why the title of "institutional economics" was particularly irksome to Ayres. Ayres would have preferred a designation which referred to the more positive aspect of behavior which was, as he saw it, technological or "instrumental." In essence Ayres appeared to defined away "institutions" as progressive instruments of control, giving them a much different meaning than they had in Hamilton's institutional economics. This becomes obvious from the following statement by Ayres:

> The only possible resolution of the enigma of power is through the evolution of free, democratic "institutions." The word "institutions" must be put in quotation marks in such a context, since free, democratic "institutions" are not institutions at all, in the strict meaning of that term. They are rather social structures in which considerations of power and status, historic authenticity and ceremonial adequacy, have been replaced by considerations of technically efficient operation [Ayres 1952, p. 394].

It is clear that in developing his institutional-technological dichotomy, Ayres's "strict meaning" of the

term "institution" did not correspond to the meaning it had in Hamilton's institutional economics. Of course Ayres acceptance of democratic "institutions" as social structures that have instrumental functions [ibid. and Ayres 1961, p. 282], as well as other remarks, especially his discussion of the efficacy of economic planning [Ayres 1952, chap. 7, 1978, chap. 12], left open the opportunity for addressing Hamilton's "problem of control" through the conscious development of institutional arrangements. For example, as Walter C. Neale has pointed out, Ayres was able to see both "instrumental and ceremonial aspects" within an "institutionalized" scientific community [Neale 1987, p. 199]. This would appear to be analogous to Hamilton's argument that certain institutional structures, such as universities, have the function of promoting technological advances. However, Ayres went on to insist that to "apply the word 'institution' to every sort of activity and behavior function is to destroy its cutting edge altogether" [Ayres 1978, 184]. For Ayres the word "institution" was best used as a description of "social behavior predominantly ceremonial in character..." [ibid.]. Hence, behavior that is instrumental in <u>function</u>, exhibited within an institutional <u>structure</u>, must occur in spite of the existence of the institution structure. This is because the <u>function</u> of institutions was most often seen by Ayres to be inhibitory of progress.

Although the fact that Ayres constructed a different taxonomy from Hamilton could seem trivial, Ayres did more than just redefine Hamilton's "Institutional Approach to Economic Theory" [Hamilton 1919a]. Rather, he muted a defining characteristic of Hamilton's "Institutional Approach" by seeming to place the development of economic systems in the context of an autonomous evolutionary process beyond the immediate control of individuals. Hamilton's institutional approach did not utilize a dichotomy between institutions and technology because both "ceremonial" and "instrumental" behavior were organized by institutions.[28] Hamilton thereby envisioned the conflict between obsolete institutions and progressive social change being resolved through the conscious creation of new institutional arrangements.

Ayres, the individual who was most likely to have been the promoter of Hamilton's version of institutional economics, in focusing upon a Veblenian dichotomy between institutions and technology to "identify the philosophical parameters of Walton Hamilton's Institutionalism" [Breit and Culbertson 1976, p. 7], developed an economic theory that

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[28]. Recall Hamilton's three-way division between the "acquisitive arts," the "industrial arts," and the "economic arts" in The Control of Wages [Hamilton 1968, chaps. 4,5, and 6]. Recall further that the "economic arts," referring to the control of "the institutions which make up the economic order" [ibid., p. 63, emphasis added], could be utilized to influence both the ceremonial (acquisitive) and the instrumental (technological) sides of the Veblen-Ayres dichotomy. See my Chapter 4, pp. 84-87.

varied considerably from Hamilton's original approach. As a consequence, Ayres would find few occasions for citing Hamilton's contribution to institutional economics, helping to explain why Hamilton has been largely ignored by modern-day institutionalists.

# CHAPTER 6

## CONCLUSIONS ON HAMILTON'S INSTITUTIONAL ECONOMICS

In constructing his paradigm of institutional economics, Walton Hamilton utilized several theoretical principles that are readily familiar to historians of institutional economic thought. Hamilton employed an evolutionary approach to the development of economic systems, a social psychology, an emphasis on inductive empiricism, and made institutions the subject matter for economic inquiry. These are characteristics that have corollaries in the work of most economists who would likely be classified as "institutionalists." What makes Hamilton's work distinctive among institutionalists is the manner in which he organized his inquiries around the "problem of control," and his conception of the nature and function of institutions in this regard.[1] Hamilton integrated abstract theory with practice by making relevance to practical problems the hallmark of his institutional approach to economic theory.

This central characteristic of Hamilton's institutional economics is not unique to heterodox economics as a whole; J.M. Clark, Gardiner Means, Rexford Tugwell, and others,

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[1]. As pointed out in Chapters 2 and 5, this distinguishing feature of Hamilton's contribution cannot be fully appreciated without an understanding of Charles H. Cooley as an important source of Hamilton's institutional economics.

exhibited concern with institutions as instruments of control.[2] However, Hamilton's contribution appears to be exceptional when compared to the "institutional economics" of the Veblen-Ayres tradition. Clarence Ayres's "institutional economics," while resulting in part from Hamilton's inspiration, did not address the problem of control in terms that seem consistent with Hamilton's approach. Therefore, Ayres was correct in claiming that "institutional economics" was a misnomer, at least so far as it would be applied to his type of economic theory. Nonetheless, Ayres did not completely abandon the title of "institutional economics," and helped to allow the singular contribution made by Hamilton to fall into relative obscurity. The practical problem of control that was central to Hamilton's institutional approach, was replaced by a dichotomy between ceremonial institutions, and instrumental technology. Thus, Hamilton's institutional economics can be said to represent a distinct, and largely unrecognized, paradigm of institutional economic theory.

Beyond satisfying academic curiosity, the sources, nature, and influence of Hamilton's institutional economics may offer some valuable lessons to contemporary economists. As with most aspects of the history of economics, there

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[2]. Clark's concern with institutions and control was noted in the previous chapter. On Means, see for example [Gruchy 1947, pp. 477 and 512]. Tugwell's article on "The Fourth Power" [Tugwell 1939] is an interesting speculation on a new institution of governmental control.

exists untapped insight and inspiration into potential problems and opportunities for the development of economic theory.

Contemporary economic problems such as airline overcapacity, rising health care costs, the rapid globalization of numerous industries, and the prospect of a 'demobilization' of the cold-war military-industrial establishment, all suggest situations wherein the market process is not the only, or even primary, instrument of control. Hamilton's work on the demobilization of labor following World War I, the control of wages and prices, and the problem of overcapacity in the bituminous coal industry, can offer some valuable insights into institutional adjustments designed to help resolve contemporary economic problems. The proposed solutions to current economic problems will of necessity involve alterations in the nature and function of both market related and non-market institutions that function as instruments of control. As an alternative to ad hoc theorizing and neoclassical economic theory, Hamilton's paradigm of institutional economics provides an organizing framework for institutional analysis of practical economic problems.

However, it is doubtful that Hamilton's institutional approach would be more successful at winning over a large number of academic economists today than it was in the 1920s and 1930s. Hamilton's failure to unify economic science

offers a lesson that cannot be overlooked. Hamilton stated in his "Institutional Approach to Economic Theory" that he was not interested in "a pointless struggle over method" so much as he wanted to address the "very nature of the problems [to] which the theorist should set himself" [Hamilton 1919a, p. 309]. As previously remarked, Hamilton was already involved in analyzing practical problems of economic policy when he presented the "Institutional Approach," and the largest portion of his written work that followed would address practical economic problems using his institutional approach. For Hamilton, the generalized description of practical economic problems was economic theory. But it is not likely to be recognized as such, not even by those sympathetic to institutional economics. Just as Wesley Mitchell was accused of "measurement without theory," Hamilton's work could easily be interpreted as "description without theory."[3] To corrupt a phrase of Mark Blaug's, how could Hamilton's "new theory... beat an old theory" [Blaug p. 713] if it was not considered "theory"?

This points to a weakness of Hamilton's institutional economics. Hamilton was prone to dismiss certain questions, such as the "pointless struggle over method," in order to

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[3]. For example, Geoff Hodgson, who is sympathetic to American institutional economics, states that "institutional economics in the past was not able to provide a theoretical system approaching the calibre of that of Karl Marx or John Maynard Keynes" [Hodgson 1988, p. 24]. Hodgson lays most of the blame upon a preoccupation with data collection and description as opposed to theory construction.

move on to the work he felt was most important. Hence, the methodological foundations of Hamilton's institutional approach seem vague and inconsistent. Hamilton gave only brief hints concerning the philosophical foundations of his methods, usually in the process of critiquing neoclassical economic theory. The terminology Hamilton used varied from one occasion to the next; he appeared alternately to be an advocate of the "organic" method, the "genetic" method, the method of "organic particularism," "generalized description," and so forth. It can only be concluded that Hamilton was a consummate methodological pluralist, having stated that,

> in these United States all economics is not of a kind. Of the craft Mr. Dooley could have remarked, as he did of philosophers, 'Th' metaphysical union is divided into minny camps and ivery mimber is a walkin' diligate' [Hamilton 1974, p. 22].

For Hamilton, formalism, a priori assumptions, and academic rigor had a low priority relative to personal creativity and the art of persuasion. Hamilton recognized and accepted the drawbacks to his freewheeling approach. According to Hamilton, the institutional approach would always,

> lack the clear-cut, definite, and articulate character of neo-classical theory. Its concern with reality, its inability to ground a scheme of thought upon a few premises, its necessity of reflecting a changing economic life, alike make its development slow and prevent it from becoming a formal system of laws and principles. It must find in relevancy and truth a substitute for formal precision in statement [Hamilton 1919a, p. 318].

In essence, institutional economics, as Hamilton envisioned it, would never have the same scientific trappings as conventional economic theory. Instead, like its subject matter of institutions, institutional economics would always be in process of development.

Thus, Hamilton did not dwell upon theoretical issues, such as his rationale for choosing the general problem of control as the centerpiece of his work, or the problem of controlling wages in general, or the specific question of how much additional income would be sufficient for mine workers. It could be said that Hamilton relied on what John Kenneth Galbraith would call the "test of anxiety" [Galbraith 1973, Chap. 20] as his justification. The identification of the problematic situation had no theoretical pretext other than relevance to a matter of public concern. This was inherently a process entailing personal judgement guided by a pragmatic desire to make things work. However, while such an approach may have its advocates, it is not likely to be viewed as "scientific economic theory" in the accepted sense.

Ayres tried to solve this problem by couching the "philosophical parameters" of Hamilton's institutional economics in more "impersonal" terms that emphasized technology as the foundation of value.[4] Thus, Ayres moved

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[4]. As Ayres put it:
> Value must be derived from an <u>impersonal social mechanism</u>, and technology is it....

away from Hamilton's emphasis on the Cooleyian conception of individuals and society remaking each other, replacing it with an emphasis on technology remaking society subject to the resistance of social institutions. This can be interpreted as Ayres's attempt to provide the institutional economist with an image of scientific detachment, where Hamilton had intended the theorist to be both an observer and active participant. Apparently Ayres had identified a subjective element in Hamilton's approach that he perceived as a crucial weakness for institutional economics. However, Ayres's theory can also be interpreted as having blunted the activist policy orientation of Hamilton's original institutional approach. This is not to imply that Ayres was unwilling to propose alternatives to existing institutional arrangements. However, in contrast to Hamilton, Ayres was not an active participant in the making of economic policy.[5]

It may be argued that it is not the primary purpose of the economic theorist to analyze the problems of present-day

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> This, I am convinced at last, is how the <u>positive</u> theory must be derived--from a technological theory of value alternative to the effort of classical political economy to derive value from the pricing process [letter from Ayres to Hamilton dated April 30, 1940, Ayres Papers, Eugene Barker Texas History Center].

[5]. For example, see [Breit and Culbertson 1976, p. 10].

institutions, and to speculate upon the possibilities for alternative arrangements. Undoubtedly it is difficult, if not impossible, for an economist to maintain an image of scientific integrity when faced with questions that are inherently normative in content. For all the formal mathematical rigor and econometric estimation making up "scientific" economic models, the policy prescriptions toward which they point can often be predicted from knowledge of the political persuasion of the economic theorist. Unfortunately there is no surefire objective method of determining what constitutes valid "scientific" inquiry. For example, econometric testing, while originally intended as a method of resolving theoretical disputes, has become, in Lester Thurow's words, "an icebreaker caught in the ice" [Thurow 1984, Chap.4]. "Scientific" economic models have, in effect, been reduced to little more than attempts at persuasion using a bewildering array of mathematics and statistics. For good or ill there is no shortage of esteemed economists willing to use such means to persuade elected officials. Thus, to dismiss Hamilton's institutional approach for making economic policy endogenous to economic theory would be to set an arbitrary standard.

The development of economic theory, like the development of economic systems, can be seen as a social process. Therefore, as a practical matter, making an institutional economic theory identifiable as theory is

necessary if it is to contribute to the analysis of current economic problems. The task of incorporating Hamilton's contributions to institutional economics into a more rigorously developed theoretical framework can be facilitated through the utilization of extant theory. As one example, Geoff Hodgson has provided a theoretical framework for institutional economics that can easily incorporate the key elements of Hamilton's original paradigm. Using elements of systems theory and modern social psychology, Hodgson has pointed towards a theory of institutional economics that views economic systems as a complex of institutions that act as instruments of control.[6] His approach is explicitly policy oriented and interventionist [Hodgson 1988, p. 269ff]. Although, as already noted (see footnote 4), Hodgson is critical of the emphasis that past institutionalists placed upon data and description, he does accept the need for "detailed and painstaking study of institutions" in order to apply "institutionalist theory to practical problems" [ibid., p. 273]. Moreover, Hodgson calls for utilizing the work of various economic theorists such as Marx and Keynes [ibid.,

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[6]. One of the lessons Hodgson draws upon from systems theory is the "law of requisite variety." The economic implication of this "law" is that there is a need for as many "controlling instruments" as there are "policy targets" [Hodgson 1988, p. 257]. This is not to suggest that Hodgson's arguments are all couched in terms consistent with Hamilton's approach. It merely shows that there is a place within Hodgson's theory for an institutional approach to the "problem of control."

p. 23] suggesting a desire to unify those "protestants" who view the workings of the economic system as a social process. It appears that Hodgson's Economics and Institutions [ibid.] has something in common with all five of Hamilton's "characteristics of institutional economics" [Hamilton 1919, p. 311]. Hence, an institutional economics that retains the key elements of Hamilton's original approach, while having adequate "theoretical" foundations, is not difficult to envision.

While Hamilton's institutional approach can benefit from incorporating more recent developments in the abstract theory of institutional economics, supporters of abstract theory can benefit from the work of Hamilton on practical economic problems. For those who question how an institutional economic theory can be put into practice addressing real-world economic problems, Hamilton's work provides an answer.

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