Throughout his work, Mitchell upheld the goal of an objective scholarship and insisted on the separation of scholarly science from reformist policymaking, which involved valuations instead of the ostensibly neutral “job of finding out as definitely as possible what happens under specified conditions.” In line with this approach, which converged with Max Weber's methodological ideas rather than with Gunnar Myrdal's skepticism about a value-free social science, the National Bureau was forbidden in its bylaws to append policy recommendations to its findings.

COMMONS AND LABOR ECONOMICS

The disjunction between scholarship and reform that Mitchell advocated made his approach contrast sharply with that of John R. Commons, the other member of the institutionalist triad. Soon after Commons joined the department of economics at the University of Wisconsin in 1904, he became associated with the progressive government of the state, then headed by Robert M. La Follette, and in a sequence of memorable experiments helped to draft legislation which often incorporated new ideas and which after a period of trial on the state level was emulated by other states and on the federal level. Counseled by Commons, the state of Wisconsin became a laboratory for the testing of precedent-setting innovations in public utility regulation, workmen's compensation, and unemployment insurance. Commons's pioneer work as a practical reformer encompassed not only labor legislation and industrial relations but a wide range of subjects falling under the broad headings of public administration and “government and business.”

The drafting of legislation required preparatory fact-finding, which Commons and his students undertook in the form of field work. Their exploration of facts and opinions resembled that of a legislative committee, the principal differences being the lesser formality of their proceedings and the fact that the interrogators examined the witnesses in the field and on the site instead of meeting them only in the halls of the legislature. Commons and his associates became quite proficient in their type of fact-finding, to which Commons, never at a loss for a name, referred as “investigational economics” and which he, as “analytical studies,” delineated from the “schedule studies” of the exponents of statistical fact-finding. It was an approach that was more impressionistic than the latter or the survey method which later came into vogue in economics, but it was more flexible than these and apt to reveal more if practiced by a master intuitionist.

Side by side with these activities Commons pursued a far-flung program of historical studies which in time made him the chronicler of the history of American labor. This program began in 1909 with an article about “American Shoemakers, 1648–1895,” in which Commons related the evolution of workers' organizations to changes in the market for their products. It was followed a year later by a monumental Documentary History of American Industrial Society, edited by Commons and his associates in ten volumes, and it culminated in 1918 in a four-volume History of Labor in the United States, of which Commons was the senior coauthor. Commons's engrossing concern with the history of labor yielded in time a genetic approach to current labor problems, which were interpreted in the light of their past evolution rather than with the help of conventional equilibrium economics. This approach became the hallmark of the Wisconsin school of labor economics over which Commons presided. Many of Commons's achievements in labor history and labor economics were the results of teamwork, as were his contributions to reform legislation. Thus, several years before the founding of the National Bureau of Economic Research, Commons pioneered in organizing research as an enterprise carried on by a group of devoted and enthusiastic followers. In the 1930s, when the government and the great foundations began to sponsor large research projects, teamwork in economic research proved to be the wave of the future.

Unlike the mathematical economists, who were apt to make their contributions early in their career, Commons's general ideas were shaped by long years of experience. Late in life, and as the crowning achievement of his work, he published Legal Foundations of Capitalism (1921) and Institutional Economics (1934). As a draftsman of reform legislation, Commons had become aware of the influence of the law on economic life and had found that the ideas of economists and lawyers about value were not always the same. In the law there had evolved the concept of reasonableness. Public utility regulation was concerned with reasonable value, labor law with reasonable wage, workmen's compensation with reasonable safety, and public officials and private citizens were expected to live up to the requirement of reasonable conduct. Commons found little in the writings of the economists that would shed light on the nature of reasonableness. It was the courts that filled the concept with substantive content, and the Supreme Court, which had the final say in the matter, had become the "first authoritative faculty of political economy in the world's history."

By stressing the impact of legal institutions on economic life Commons made his work reflect the growing interventionism of the modern age. During the era of laissez faire economists would proceed on the assumption of severely restricted functions of government, which appeared to them as an instrument that protected the rich against the poor and as a guardian of property rights and contractual obligations. Now, with an increasing range of governmental functions, the state had ceased to be a mere night watchman, and the effects of various types of legislative interference on the economy were waiting for analysis. Commons's interest in legal institutions reflected a phase of economic interventionism which is the latter made itself felt primarily in the form of regulation rather than through measures of fiscal policy that would point toward central planning. As regards such planning, Commons, in his Institutional Economics, expressed doubts about the competence of democracy and representative government to manage it. He has rightly been characterized as a "conservative reformer."

In Commons's Institutional Economics, the vista widened and encom-
passed not only action on the governmental level but all "collective action" such as that undertaken by organizations of labor, farmers, business, and other bodies that constitute the pluralistic universe of the American economy in the twentieth century. In this work Commons defined an institution as "collective action in control of individual action" or, more specifically, as "collective action in restraint, liberation, and expansion of individual action." The older economics had disregarded institutions because it envisaged economic relations as prevailing not between man and man but between man and nature—between human labor and the resistance of nature's forces, as in classical economics, or between the quantity wanted of nature's forces and the quantity available, as in marginal utility economics. The older economics had constructed a pure theory based on the physical exchange of materials and services but had neglected the fact that what counted were not physical entities but property rights. This point of view of the older economics Commons contrasted with his own, which called for attention not to individuals and nature's forces but to the mutual transfers of property rights, out of which human beings got their living. Commons's institutional economics was conceived as a broad synthesis of law, economics, and ethics, which recognized both conflicts of interest and their mutual dependence as well as the need for security of expectations or order. The basic concept of institutional economics was not the commodity or the exchange but the "transaction." Of the latter Commons wrote:

Transactions intervene between the production of labor, of the classical economists, and the pleasures of consumption, of the hedonic economists, simply because it is society that, by its rules of order, controls ownership of and access to the forces of nature. Transactions, as thus defined, are not the "exchange of commodities," in the physical sense of "delivery," they are the alienation and acquisition, between individuals, of the rights of future ownership of physical things, as determined by the collective working rules of society. The transfer of these rights must therefore be negotiated between the parties concerned, according to the working rules of society, before labor can produce, or consumers can consume, or commodities be physically delivered to other persons.

With considerable powers of construction, Commons filled in the further details of his far-flung conceptual scheme of institutional economics. There was a far lesser response, however, to this aspect of his work than to his activities as a reformer and initiator of the study of applied fields of economics. Students of Commons and their students in turn would cultivate these and add to the master's legacy by drafting the social security legislation of the 1930s. But Commons's theoretical message, made public in 1934, although it did not exactly fall on deaf ears, was soon forgotten and not followed up by allied efforts aiming at the redirection of economics. His message was more relevant to the regulatory phase of interventionism, when the legal merits of the regulatory measures formed the subject of a heated debate, than to its later phases, when the great legal issues had been resolved and fiscal policy rather than regulation moved into the foreground of public policy. The impact of Commons's Institutional Economics was weakened by the publication, only two years later, of Keynes's General Theory, which overshadowed all other work. There are limits to the capacity of a profession to absorb new ideas; coming to terms with Keynes strained this capacity to the utmost.

The question may be asked why institutional economics as developed by Veblen, Mitchell, and Commons remained a unique feature of American thought, which found few parallels elsewhere. There were, to begin with, the specific characteristics of the American intellectual atmosphere which provided a fertile ground for the rise of institutional economics. Abroad, these characteristics were absent, and apart from this there were in the various countries factors in operation that stemmed the rise of kindred thought. In Germany the historical economists were in control for almost the whole century preceding World War II. Since conventional theory was deposed and had hardly any followers, there would have been no suitable target for an attack along institutionalist lines. A target was missing also in France, where economics was in the doldrums during the period in which institutional economics flourished in the United States and where the great pioneers of mathematical economics received only scant recognition at that time. The only French economist whose work converged with that of the institutionalists was François Simiand (1873-1935), who applied similar methods to the study of the long-range movement of prices and wages.

In England, Marshall's theory was less pure than that developed by Clark and the American followers of the Austrians, and except for the one-man crusade of John A. Hobson (1858-1940) there was no revolt against it comparable to that which took place in the United States. Hobson had little influence on academic economics in England, but to him was due an early formulation of the idea of oversaving, then—in 1889—universally rejected by respectable economic opinion but later memorialized by Keynes, and the first exposé, in 1902, of imperialism, one later exploited by Lenin and other followers of Marx in their denunciations of capitalism.

The generations of American economists who succeeded Veblen, Commons, and Mitchell included only a few who would claim to be institutional economists. In fact, standard economic theory became ever more pure instead of descending to a lower level of abstraction, as the institutionalists had suggested. Although conventional theory did not surrender to the institutional approach, it nevertheless purified itself, by the devices of its own logic, of some features that the institutional economists had found particularly offensive. Thus the pure theory of consumption was emptied of utilitarian content, the spectrum of monopolistic competition replaced the polarity of competition and monopoly, and macroeconomics added a social dimension to individualizing microeconomics. Moreover, at least one great figure who was steeped in pure theory—Schumpeter—went beyond the confines of conventional theory and raised broad questions about the future.
leading to the study of the economic development of backward countries, to which an increasing number of economists were drawn after World War II. Some of this work proceeded along the lines of pure theory, but it also opened up opportunities for studies on a lower level of abstraction, for the exploration of development problems within the contexts of varied cultures, and for the interdisciplinary utilization of the resources of such allied sciences as history, anthropology, sociology, and political science, approaches closer to the institutionalist program than to conventional theory.

**J. M. CLARK**

Leading American economists whose work linked them with the institutionalists in one way or another included John M. Clark (1884-1963), Simon Kuznets (b. 1901), John Kenneth Galbraith (b. 1908), and Kenneth Boulding (b. 1910). Clark worked under the influence both of his father's tradition and that of the institutionalists. Although he adhered to the framework of conventional theory, he considered it overly pure and attempted to make it more realistic and socially useful. With this aim in mind, he developed the concept of workable or effective competition, designed to serve as a standard of socially acceptable business behavior. Among Clark's contributions to theory was his discovery, in 1917, of the principle of acceleration of derived demand, according to which changes in consumption or output bring about magnified changes in investment. This was again a multiple discovery, credit for which Clark shared with the French economist Albert Aftalion, who explained—but did not name—the operation of the principle in 1909.

**KUZNETS**

Like other scholars connected with the National Bureau for Economic Research, Kuznets continued Mitchell's tradition of statistical fact-finding. Whereas Mitchell devoted his life to the study of business cycles, Kuznets turned to other fluctuations—seasonal ones and secular movements—then to national income estimation, and later to studies of economic growth. The Kuznets cycle, an intermediate wave with a duration of fifteen to twenty-five years, was discovered by Kuznets and was named after him.

**GALBRAITH**

Galbraith's criticism of the "conventional wisdom" echoed Veblen's strictures. His works, written with enthusiasm and wit and replete with political implications, appealed to a large public and were more widely commented upon than the writings of other contemporary economists. The key words of Galbraith's most influential writings were "countervailing power," "affluent society," and "technostructure." Oligopoly, he argued, was under the discipline of countervailing power, which compelled one oligopolistic concern to bargain with another—a steel producer, for example, with an automobile manufacturer. The affluent society provided plentifully for the satisfaction of wants created by advertising, but it starved the supply of public services that would keep air and water clean, make cities livable, improve education, and so forth. Many productive activities, Galbraith pointed out, derived their social value not from the production of useful goods but from the employment that they provided and from the income that they generated. To the technostructure rather than to owners and managers Galbraith attributed decisive power in the "industrial society," in which consumers' sovereignty was replaced by the large concerns' control over the market and in which the power of the latter over society was checked not by labor unions but by the educational and scientific estate.

**BOULDING**

Discontent with conventional economics was also expressed in the writings of Boulding, whose bill of particulars included the lack of integration of economics with the other social sciences and the absence of a macroeconomic theory of distribution. Boulding's *Reconstruction of Economics* (1950) contained proposals for the removal of these and other faults. Although he was critical of the work of the institutional economists, his own ideas, with their biological and physiological analogies and his search for a unified social science, had a certain affinity with theirs.

**AMERICAN SCHOOLS OF THOUGHT**

Of the scholars mentioned in the preceding paragraphs, Kuznets and Galbraith were members of the Harvard faculty, as were Schumpeter, Chamberlin, and Leontief, whose contributions have already been assessed. Besides a number of other scholars of great renown, the Harvard department included Alvin H. Hansen (b. 1887), the leading exponent of Keynesian economics in the United States, who lent his support to the propagation of Warren's ideas long before they had become accepted as part of the standard doctrine. The Harvard group formed no school; its eminence was based on the variety of the points of view outstandingly represented by its members.

**THE CHICAGO SCHOOL**

The followers of Keynes in the United States formed no school because their point of view within a short span of time was absorbed by what soon became a new orthodoxy to which the great majority of the profession adhered. Some of those who took exception to Keynesian economics and to the theories of monopolistic competition did, however, constitute a closely
Finally, we must acknowledge Veblen's normative contribution to economics. Running throughout his writings is not only a scientific dissent from orthodoxy but an ethical dissent. Whereas orthodox theorists, such as Veblen's teacher J. B. Clark, were amazed at the material welfare produced by the modern industrial economy, Veblen saw his satiric posture of objectivity to describe an economy shot through with illaire. Veblen became a rallying point for many who felt that government action might remedy some of the most glaring faults of a pecuniary culture.

WESLEY CLAIR MITCHELL:

In 1896 Wesley Clair Mitchell (1874-1948) entered the University of Chicago to study classics. After taking courses from John Dewey and Thorstein Veblen, he became more interested in philosophy and economics and finally decided to pursue economics. Mitchell went on to become a leading American economist of the twentieth century: an authority on business cycles, a pioneer in establishing a research agency for studying the economy, and an astute observer of the development of economic theory. Although Mitchell did not fully accept many of Veblen's ideas, his economics was not orthodox, so he is usually identified with the so-called institutionalist school. He accepted and amplified some of Veblen's criticisms of orthodox economic theory, but he made no attempt to build a complete theoretical structure to explain the evolution of the industrial economy. Mitchell attempted to follow what Veblen recommended in his essays on methodology, researching carefully and grounding all his theoretical work in empirical information. His example as a scholar and researcher and his work in setting up the National Bureau of Economic Research to collect and analyze macroeconomic data have been more important than his contributions to pure theory.

Mitchell's views about orthodox economic theory are expressed in a number of his essays and in his *Lecture Notes on Types of Economic Theory*. In an unusually candid letter to J. M. Clark, he revealed the turn of mind that deflected him from the mainstream of economic theory. Mitchell said that at a young age he began to prefer concrete problems and methods to abstract ones. He recalled a great aunt who "was the best of Baptists, and knew exactly how the Lord had planned the world." Mitchell remembered how he developed "an impish delight in dressing up logical difficulties which my great aunt could not dispose of. She always slipped back into the logical scheme, and blinked the facts in which I came to take proprietary interest." Mitchell accounted for his particular approach to economics by citing the fact that when he went to Chicago he studied both philosophy and economics. He found economics easier than philosophy and thought the economic theories from Quesnay to Marshall "were rather crude affairs compared to the subtleties of the metaphysicians.... The technical part of the theory was easy. Give me premises and I would spin speculations by the yard. Also I knew that my 'deductions' were futile." Mitchell was impressed with Veblen and felt "that few could match him in spinning out theories." Yet Mitchell recognized that Veblen's system had the same methodological weakness as did orthodox theory; both failed to test either their assumptions or their conclusions satisfactorily. "But if anything were to convince me that the standard procedure of orthodox economics could meet no scientific tests, it was that Veblen got nothing more certain by his dazzling performances with another set of premises." This particular attitude is manifested in two of Mitchell's lifelong efforts. In his study of the history of economic ideas, he was interested not in what particular theorists said, but in why they attacked certain problems and not others, why they accepted certain premises without question, and why their contemporaries rejected their conclusions and thought them significant. Mitchell's work in the history of economic theory possibly represents the best of the relativist position. He concluded that economic theory can be largely explained as an intellectual reaction to problems of the times. This attitude is also manifested in his work on business cycles. He left behind no theory of cycles founded upon abstract premises from which conclusions could be deduced. His approach was a careful construction and explanation of time series as a preliminary step to checking the tentative theories he offered. At times his work on business cycles appears almost atheoretical, yet there is a theoretical structure underlying the entire analysis.

Mitchell criticized the abstract models of orthodox theory. "Economic theory of the speculative kind is as cheap and easy to produce as higher mathematics or poetry—provided one has the gift. And it has the same problematical relation to reality as do those products of imagination." He also objected to the hedonistic psychological assumptions of orthodox theory but did not accept Veblen's instinct theories. He claimed that the social sciences could develop a better explanation of the activities of humans by basing their explanation upon
empirically grounded behaviorist psychology, and he advocated a more generalized approach to studying human behavior than could be achieved by letting the various branches go their own ways. Orthodox theory had incorrectly focused on normality and equilibrium in the system instead of examining its dynamic interrelationships.

Mitchell particularly emphasized the evolutionary cumulative causation approach in his study of the business cycle. Implicit in Mitchell’s writings is an ethical dissent as well as a scientific dissent from orthodox theory. Mitchell, who hoped to use economic knowledge to improve welfare, maintained that a study of the economy revealed a need for national planning in order to achieve better integration of the activities of firms and better control of fluctuations in economic activity.

Mitchell took Veblen’s distinction between pecuniary and industrial employment as a broad guide in his approach to the study of business cycles. Fluctuations in economic activity can be accounted for largely by the reactions of businesses to changing rates of profit. Because business decisions are made in a setting of expectations and uncertainty, the businessperson’s investment decisions always reflect either an optimistic or a pessimistic outlook on the future. Fluctuations in economic activity are to be expected in economies with developed monetary systems; therefore, orthodox theory, with its conceptual framework of normal, static, and equilibrium, is not appropriate. Mitchell did not attempt to build another abstract model of the business cycle. He tried instead to explain what happens during the business cycle, giving what he called a descriptive analysis of the cycle. Because each cycle is unique, the possibility of developing a general theory is restricted; yet all cycles have certain similarities, because all reveal the interactions of economic forces during the various phases of depression, revival, prosperity, and crises.

Although others before Mitchell had seen the cycle as a self-generating process, he was the first to give this conception explicit form and to support it with extensive empirical data. His explanation of the cycle is based on business reactions to changing levels of profits. A depression carries the seeds of the subsequent revival as interest rates fall, inefficient firms are eliminated, both fixed and variable costs decline, inventories decrease, and so on. Prosperity also carries the seeds of crisis and subsequent depression as costs rise, with a consequent squeeze on profits.

Mitchell’s descriptive analysis, reflecting as it does a scholar’s judicious blend of theory, description, and history devoid of mathematical encumbrances, is somewhat like Marshall’s. Yet the hard theoretical core that underlay Marshall’s microeconomic analysis was missing, to such an extent that some call Mitchell’s work measurement without theory. Others, with post-Keynesian hindsight, find in it the multiplier process, the accelerator principle, and a counterpart to Keynes’s marginal efficiency of capital and liquidity preference. Mitchell believed that business cycles cannot be considered apart from the rest of the economy; they are part and parcel of the system and are, in fact, generated by the system. As each phase of the cycle evolves into the next phase, the institutional structure of society changes so that “economists of each generation will see reason to recast the theory of business cycles which they learned in their youth.”22

In 1920, at the age of forty-five, Mitchell founded the National Bureau of Economic Research. This private, nonprofit organization has been tremendously important in financing economic research in the United States. Although its most important efforts have involved the measurement of national income and business-cycle research, it has sponsored research in nearly all areas of the economy. If we were studying the development of economic research in the United States, Mitchell’s role would require at least one long chapter. In Chapter 16 we will see some direct influences of Mitchell in the work of some of his students—Simon Kuznets, for example—and some indirect influences in the work of economists who were more interested in measuring economic activity than in producing abstract deductive models.

**JOHN R. COMMONS**

John R. Commons (1862–1945), five years younger than Veblen but twelve years older than Mitchell, was another heterodox economist from the midwestern United States. Born in Ohio and reared in Indiana, he attended Oberlin College and received the standard classical education of the time, which included a heavy dose of theology dispensed by professors who were quite often members of the clergy. He did graduate work in economics at Johns Hopkins, where he was strongly influenced by Richard T. Ely.

Because Ely had studied in Germany and had been influenced by the German historical school, political economy at Johns Hopkins included economics, political science, sociology, and history. Ely’s interest in labor economics—he published Labor Movement in America in 1886, two years before Commons went to Johns Hopkins—was transmitted to his student, and Commons contributed to this area of economics throughout his career. Commons left Johns Hopkins after two years and taught at several places before finally following Ely to Wisconsin in 1904.

At the University of Wisconsin, an approach to economics, sometimes called the Wisconsin school, was developed, largely under the influence of Commons. This approach was important in sustaining economic heterodoxy in the United States and in initiating reforms that have changed the structure and functioning of the American economy. Until he came to Wisconsin, Commons had not been retained long at any university, possibly because of his political and economic views and possibly because he was not well received as a teacher of undergraduates. At Wisconsin, however, he found fertile soil for his visionary dissent and even received encouragement from progressive politicians who were eager to find academic experts willing to support social reform.

---

During his twenty-eight years at Wisconsin, until his retirement in 1932, Commons made significant contributions to economics in three broad areas: social reform, graduate education, and labor economics. Perhaps his most significant contribution was the social legislation he was instrumental in formulating. This legislation has changed the structure of the American economy. Commons's first book, *Distribution of Wealth* (1893), was not well received. Critics found it an unsatisfactory attempt to establish a scientific basis for his socialist ideas. Yet Commons was not a revolutionary attempting to change the structure of a private-property, free-enterprise society. He believed that the essentials of capitalism could and should remain intact, but that changes in the working rules of the economic order were needed to remove the obvious faults of a laissez-faire economy. In Wisconsin he found support for his position from Governor La Follette.

During Commons's years at Wisconsin (1904–1932), a relationship developed between academics and politicians that was repeated on a national scale in the New Deal of Franklin Roosevelt, a relationship that has become commonplace today. The state government of Wisconsin made extensive use of the faculty at Madison as a brain trust for new ideas, as drafters of legislation, and as members of appointed commissions. A history of Commons's career at Wisconsin reveals that he spent a great deal of time helping to draft, pass, and implement social legislation.

In these efforts a discernible pattern developed. Commons would thoroughly study a problem, often with the help of his graduate students. He would then discuss the issues with those in the economy who would be influenced by any new legislation and get the support of the more progressive businesses or labor leaders. After the legislation was passed, he would travel and use other means to promote the spread of the new legislation to other states. There is little doubt that a number of ideas that took shape in the social legislation of the New Deal came from Wisconsin. And there is no question that many economists and others trained at Madison moved to Washington, D.C., in 1932.

**Commons's Legacy**

Commons has been described as "the intellectual origin of the movement toward the welfare state." He was a former student of Commons, Harold Groves, then both a senator and a professor of economics specializing in public finance at the university. In 1934, when Roosevelt urged Congress to pass an unemployment compensation law, he formed a committee on economic security to propose legislation; its director was a student of Commons, E. E. Witte, then a professor of economics at Wisconsin.

Commons's efforts in these areas of social legislation proceeded from his conviction that the modern industrial economy required government intervention if it were to function properly and if social justice were to be achieved. Much of the legislation originating in Wisconsin would not strike modern readers as particularly radical, visionary, or even socialism. Yet in Commons's time these ideas for social reform were not generally accepted in the United States. Commons represents, on this score, an unusual type of heterodox economist.

He did more than merely object to the orthodox theory that for the most part the market was best left alone to allocate resources; he was interested in changing the situation through social legislation and participated actively in the endeavor to do so. Not all his efforts were successful; for example, he did not succeed in achieving a national health insurance program.

A second contribution of Commons is related to his endeavors in the area of social reform. The economics department of the University of Wisconsin became known as a major graduate training center for economists throughout the world. At one time more Ph.D. degrees in economics were being granted by Wisconsin than by any other university. More important, Commons's particular approach to economics became embedded in the fabric of the department; thus, until the 1980s, a "Wisconsin school" approach was maintained. This legacy is in sharp contrast to that of Veblen or Mitchell, who had no lasting impact on any graduate program.

The economics departments of the University of Texas at Austin under the leadership of C. E. Ayres and of the University of Maryland under Allan Gruchy also sustained particular heterodox approaches for short periods of time, but the number of Ph.D. degrees granted by those institutions and their influence were small compared to Wisconsin's. Greater historical perspective will be needed to understand the demise of the Wisconsin school approach and, more generally, the end of the concentration of graduate education in heterodox economics in particular departments. With the exception of a few members of their faculties, Wisconsin, Texas, and Maryland seem safely back in the orthodox fold.

In any event, it appears that Commons's approach was not sustained or carried to other universities by its graduates because the economists trained at Wisconsin were, for the most part, oriented toward applied fields of economics rather than toward economic theory. Legions of them went out to serve in government, in research agencies, and in universities. But being interested in issues such as labor, public finance, and public utilities, they took little interest in orthodox theory, which was then almost exclusively microeconomic. Commons, as we will see, criticized orthodox theory but spent most of his time in applied fields and in social reform.
Commons's Economic Ideas

Although Commons arrived at his criticism of orthodox economic theory independently, it parallels that of Veblen and Mitchell. His entire approach to social problems rejected the narrow, static, deductive approach of neoclassical theory. Commons tried to bring all the social sciences and law into the analysis. He viewed society and the economy as evolving and changing and sharply objected to the almost exclusively deductive approach, with its assumptions of hedonistic agents and competitive markets. Finally, Commons found that the implicit assumption of harmony in the economy, on which the laissez-faire policy was based, was contrary to his empirical observations.

The starting point for Commons's analysis of American capitalism was the same as that of orthodox price theory, but the analyses themselves were quite different. He asserted that the orthodox theory of price formulation and exchange was unrealistic. It assumed rational individuals acting almost mechanically in competitive markets. Commons said that it is not atomistic, hedonistic individuals acting in competitive markets that form the exchange relationships connecting the separate parts of the economy. Orthodox price theory might satisfactorily explain exchange and price in a few very special situations, such as highly organized commodity or security markets, for in these markets there are exchanges but no exchange relationships. In these markets, where there is complete anonymity between buyer and seller, habit, custom, and all the cultural, sociological, and psychological forces that impinge on usual market transactions are absent. Transactions became a key element in Commons's theoretical structure:

In fact, transactions have become the meeting place of economics, physics, psychology, ethics, jurisprudence and politics. A single transaction is a unit of observation which involves explicitly all of them, for it is several human wills, choosing alternatives, overcoming resistance, proportioning natural and human resources, led on by promises or warnings of utility, sympathy, duty or their opposites, enlarged, restrained or exposed by officials of government or of business concerns or labor unions, who interpret and enforce the citizens' rights, duties, and liberties, such that individual behavior is fitted or misfitted to the collective behavior of nations, politics, business, labor, the family and other collective movements, in a world of limited resources and mechanical forces.24

Commons found three types of transactions in the economy. "Bargaining transactions transfer ownership of wealth by voluntary agreement between legal equals."25 Legal equality does not imply equal economic power. Bargaining transactions that determine prices in final and factor markets are the subject matter of orthodox price theory, but this theory is really applicable only to the unusual situation of competitive markets in which bargaining power, coercion, persuasion, habit, custom, and law are ignored by assumption. A second type of transaction is the managerial transaction, which involves commands by legal and economic superiors to inferiors. "It is the relation of foreman and worker, sheriff and citizen, manager and managed, master and servant, owner and slave."26 Managerial transactions involve the creation of wealth. The third type of transaction Commons identified is rationing transactions. They involve "the negotiations of reaching an agreement among several participants who have authority to apportion the benefits and burdens to members of a joint enterprise."27 Commons then went on to define what he called institution:

These three types of transactions are brought together in a larger unit of economic investigation, which, in British and American practice, is named a Going Concern. It is these going concerns, with the working rules that keep them going, all the way from the family, the corporation, the trade union, the trade association, up to the state itself, that we name Institutions. The passive concept is a "group"; the active is a "going concern."28

Institution is defined as collective action in control, liberation, and expansion of individual action. Economic transactions involve conflict—the more I receive, the less you receive. These conflicts are not manifest in most transactions, because

25Ibid., p. 64.
26Ibid., pp. 67-68.
27Ibid., p. 69.
over time, precedents are established by custom, habit, law and so forth, that bring order out of conflict. Commons called these precedents working rules of the going concerns.

With this bare outline of Commons’s approach, it is possible to outline his analysis of American capitalism. Neoclassical theory held that the conflicts arising from problems of scarce resources could be solved in impersonal competitive markets, which by assumption removed all cultural, sociological, psychological, and legal elements from the analysis. It maintained that for the most part, the working out of these conflicts in competitive markets led to results that were superior to any results that might be achieved through governmental intervention.

The basic thrust of Commons’s approach was to include the social sciences, history, and law in his analysis and to recognize that government intervention was often necessary to bring about desirable social consequences. Most of our economic activity is not individual activity; we act as members of groups that are guided and molded by the working rules of going concerns. Although the function of these working rules is to bring order out of conflict, at times changes brought about by history lead to new conflicts. These conflicts or disputes are then settled, and the old working rules are modified. This is an endless, ongoing process. The proper subject matter of economics, Commons maintained, is the institutions that shape our lives and society by means of collective action. This collective action not only controls individual action but also liberates it by freeing the individual “from coercion, duress, discrimination, or unfair competition, by means of restraints placed on other individuals. And collective action is more than restraint and liberation of individual action—it is an expansion of the will of the individual far beyond what he can do by his own puny acts.”

Because an unregulated economy produces undesirable social consequences, capitalism needs to be modified by governmental intervention. Monetary policy to prevent depression, legislation to recognize the right of labor to organize, workers’ compensation to assist the unemployed, health and accident insurance to care for the unfortunate, regulation of public utilities to prevent monopoly practices, and other social reforms were advocated by Commons. Thus, although he had almost no impact on orthodox theory, the reforms he advocated and helped to implement have significantly influenced the institutional structure of American capitalism.

JOHN A. HOBSON

Although England was the citadel of orthodox economic theory from Smith through Marshall, with its main tenet being that unregulated markets will produce a maximum of social welfare, there have been legions of heretics. Possibly the most influential of these was John A. Hobson (1858–1940), whose heterodox ideas became the intellectual wellspring of the present English welfare state. Hobson’s academic career was ended shortly after the publication of his first book on economics. He lost his job because of “the intervention of an Economics Professor who read my book and considered it as an equivalent in rationality to an attempt to prove the flatness of the earth.” An independent income allowed him to continue his attack on orthodox theory, however, and he published nearly forty books as well as a large number of articles. His works were never well received in academic circles until Keynes praised him in the General Theory; and although Hobson’s impact on pure theory has been almost negligible, he has been important in shaping English economic policy. Hobson is like many heterodox economists who had a vision of the inadequacies of orthodox theory and were able to describe them but who were never able to formulate a theoretical structure capable of overthrowing accepted doctrine.

In broad perspective, Hobson’s heterodoxy was an attack on the accepted doctrine that laissez faire is the best policy, because markets will produce a maximum of social welfare. Orthodox theory held that competitive markets will, for the most part, produce the goods that sovereign consumers desire at the lowest possible social costs. The distribution of income that flows from these markets rewards the participants according to their productivity. Furthermore, the operation of these economic forces will produce a full utilization of society’s resources. Because prices are, in general, good measures of the costs incurred and the utilities produced in the economy, they are indexes of the welfare achieved by a society.

Although Hobson accepted some of the major assumptions of orthodox theory, he came to quite different conclusions about the adequacy of a laissez-faire market economy. He found three major faults with the workings of the English economy of his time. First, it failed to provide full employment, because there existed chronic underconsumption or oversaving. Second, the distribution of income unjustly rewarded those in upper-income groups, largely because of their superior bargaining power. Third, the market is not a good measure of social costs and social utilities, for the entire price system is oriented toward monetary profit. Whereas orthodox thinkers found harmony in the economy and then built a theory to demonstrate that harmony, Hobson ascribed the negative influence of the laissez-faire economy and then attempted to build a theoretical structure to remedy the faults of the existing industrial society. Hobson contended that if the goals of a society were clearly defined, a knowledge of economic theory would permit the society to achieve “the good life.”

He objected to John Neville Keynes’s position that we can distinguish between what is and what ought to be and to the orthodox tendency to confine activities to an analysis of what is. For Hobson, economic theory was useful precisely insofar as it would assist society to achieve “oughts.” The normative-positive dichotomy attempted by orthodox theory was impossible, because the same facts

29 Ibid., p. 73.