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**THE INSTITUTIONAL
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BY RADHAKAMAL MUKERJEE

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THE INSTITUTIONAL THEORY OF ECONOMICS

By

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SIR KIKABHAI PREMCHAND LECTURES, 1939-40
UNIVERSITY OF DELHI



MACMILLAN & Co., LIMITED
ST. MARTIN'S STREET, LONDON

Delhi University Publication : No. X

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PREFACE

In the past economics developed its methodic procedure in consonance with the broad movements of thought of the time. In Adam Smith, and John Stuart Mill in particular, we find a recognition of the significance of the institutional and humane relevance of economics generally. In recent times when the social evils of modern capitalistic industry and bitter class antagonisms have called for comprehensive measures of political control and institutional rearrangement, economics, however, has largely weaned itself from the humane tradition, characteristic of the stage of its rise into importance, and emphasised a rigidly positive analysis in an autonomous sphere, where, nevertheless, both the basic institutional presuppositions and conjuncture constantly change.

Neither modern biology, with its deeper understanding of the social processes of selection and survival of institutions and valuations, nor psychology with its stress of manifold impulses as roots of individual behaviour, and of institutions and cultural conditions in the final shaping of desires, valuations and human relations has much significance for economic analysis. The dissociation of economics from biological and psychological methods and outlook has fostered what John Dewey calls a "metaphysical individualism", the notion that an adequate theory of human behaviour can be formulated by considering individuals apart from the institutional setting, and also a separation alleged to exist between the world of facts and the realm of values. This can only disappear when valuation-phenomena are seen to have their immediate source in biological modes of behaviour and to owe their concrete content to the influence of cultural conditions. The latter is studied by anthropology, politics

and sociology; no wonder that "economic individualism" persists side by side with the neglect of the filiation of economics with these studies, which also have started, like economics, with an abstract, generalised individual, instead of studying human relations and behaviour in their concrete, cultural background.

The change in the outlook in both basal and borderland sciences urgently demands a change of the focus of attention from value to economic behaviour in a larger setting, from discrete individual behaviour to collective mores and institutions, and from the stereotyped institutions of 19th century liberal capitalism to the changing social world of to-day. The clue to economic processes is now increasingly discerned less in the rationality and responsibility of the atomic individual, and more in man's social contacts, institutions and values which constantly modify and are modified by the economic processes. And yet how fondly does economics still cling to the hedonistic view of human nature and social action, to the simple competition postulate of "economic individualism" and to the central scientific assumption, the mechanical analogy, bequeathed by the Classical school, who built their frame of reasoning in steel before the advent of the biological sciences and their many-sided applications to social life and organization.

Far-reaching changes have also come about in the 19th century in industrial technique, organisation and employment, introducing immobility of real capital, monopoly, organized trade-unionism and wage fixation, which have not only created new rigidities and distortions of the circular flow of wealth, effacing the classical state of the objective equilibrium, but also stimulated protectionism and economic imperialism and autarchy, preventing the isolation of economic from political and cultural sphere in the study of causal relations. All these make the earlier social and institutional pre-suppositions of economics somewhat untenable, and even

misleading. As private property and freedom of enterprise have been steadily curtailed, as both state action and centralised planning have spread, and as national and racial standards of behaviour have obscured simple economic incentives, the generalised equilibrium theories of the Classical system, grounded on the subjective equilibrium of individual valuations, have shown their inadequacy, and the analysis of economic situation in terms of new norms has become indispensable. The latter have now largely modified or restricted, and in some countries virtually replaced, the competitive system with its associated legal-economic institutions, notions and outlook, and to this extent made the Classical equilibrium analysis an anachronism.

For it is the task of economics to find out an optimum optimum under different or alternative institutional framework of incentives, laws, freedom and property distribution, and not the optimum of competitive equilibrium as the goal of economic policy. Neither the institutional framework nor the norms have, however, been precisely defined nor have been subjected to critical examination as economic data or pre-suppositions, derived as these are from the integrated system of indivisible social values as contrasted with the divisible, individual values of the Classical price-cost equilibrium. An adequate analysis of these and a fresh consideration of both the order of social distribution and the motives of production and consumption thus seem essential. For rival economic systems have emerged where the standards of state demand and public welfare prove as effective incentives as "natural liberty", private property and profit.

Human motives and relations, traditions and means of social persuasion and control make up the framework of institutions which give a durable form to man's manifold desires, values and efforts, and which harmonise between individual and social interests and ends, and between one field of social relations and another, regulating the dynamics

of economic equilibrium which is a social, composite and normative rather than an individualistic, single and analytical equilibrium. It is only from sociology that economics can import a real understanding of the essentially social character of the whole movement, shaped as it is by the prescriptive force of institutions rather than by the individual's atomic urges, by the entire system of social ends rather than by the mere economic norm of efficiency. The mere fact that economic efficiency can be measured more exactly by the price-cost mechanism should not preclude economics from the consideration of the integrated system of norms and ends, which alone makes social life possible, and guides the individual in his choice of goods and activities in the exchange economy. These latter derive their meaning only with reference to social norms and ends; economic values accordingly are not causal but symbolic of the social relations which sociology depicts and seeks to analyse quantitatively. It is sociology which, above all, furnishes the realistic middle principles of any historical epoch,—the theory of agricultural communalism, of industrial capitalism, of collective socialism etc.—arranged in order and relative importance that can serve as keys to the interpretation of exchange economy, as categories of a determinate system of economic relations and objective processes in dynamic interplay. The American Institutionalists were right in their criticism of the sociological preconceptions of Classical economists, but did not work out the new sociological findings into economic data, indicating the qualitative structure of social relations in terms of a quantitative order of prices and volumes in the market process. Thus the vital contribution of modern sociology towards the appreciation of inter-relations of various phases and levels of man's social action and analysis of social causation which indicates the continuous intermingling of social data and norms and the economic process hardly influence the corpus of economic theory.

Within an autonomous sphere of "rational economic action" the deductive method pursues its analysis by abstracting man's economic efforts and relationships from the web of group and institutional relations, disregarding the "whole" view of social life that sociology furnishes. The result is that theories are developed which are logically consistent but which are little based on factual data since inadequate, unrealistic and even false premises form their stuff; these gain in complexity, and yet remain below the level of verification, and accordingly often contradict one another. Thus economics becomes reduced in status and scope to that of econometrics, an enormously useful division of economics since it refines and sharpens the logical apparatus of the science but which is not the whole of the science. Statics and dynamics are not engineering. Much less can econometrics be political economy.

More than that. The search for a systematic orderliness of "economic action" within a narrowed, independent and non-interacting field gets the better of the examination of the origins and types of economic institutions and of the relations between the individual and institutions in their different levels of adjustment, which we have analysed into ecological, economic and institutional in an ascending order, and from purposes in which not only the theories of returns and population, price and cost, but also the theories of value and effort, rights and duties emerge. The relation between economic and moral values and the theory of social and economic rights are of special relevance in contemporary economic life with its need of a harmonious coordination of property and work, of law and economic freedom, and of economic and political rights. Nor does economics tarry to consider the working in detail of the changing institutions in the entire background of social and political organization. It is here that concrete economic action and relations of individuals are seen as phases of a coherent system of purposes or ends of individuals and

the society, which show a continuous, reciprocal and progressive adaptation. But many orthodox theorists in their zeal for finding out mathematical uniformities in economic action would consider institutions as fixed, definitive and unyielding, not to speak of directing economic processes and institutions towards new social aims in accordance with the changing whole situation. The formulation of an integrated system of social norms which could be quantitatively expressed by institutional economics, working hand in hand with descriptive and statistical sociology, would remove the present contradictions between welfare economics and price economics as regards the aim of economic action. Where there is divergence of such norms as those of individualism, socialism or collectivism nor are optimal indices agreed upon, it will be necessary to present these as alternatives and compare the probable consequences in the practical social situation. This will not only introduce a flexibility in the logical apparatus of price economics, but will also exclude a pre-judgment of social ends treated as alternative hypotheses or plans in problematic situations.

Political science, jurisprudence and ethics which deal with spheres of social relations that constantly impinge upon the economic process, all have set up and clarified valuable social norms and categories arising out of an ordering of social aims and balancing of the different levels of life in the unity of the cultural process. But these are often unceremoniously disregarded by economics as something disturbing, random or adventitious. Such treatment is facilitated by the fact that the norms or standards imported from the other social sciences often persist in the qualitative form without being transformed into quantitative expressions and relations in economics. The inadequate development of quantitative methods in the other social sciences is in fact in no small measure responsible for the persistence of the Classical methodic procedure in economics. On the other

hand, economics with a view to retain its mathematical elegance and symmetry fights shy of the norms and data from the other social sciences in reconstructing its foundations, and thus fails to give either a true picture of the economic system or an adequate guidance to economic planning and policy in the changing social situation.

In actual life, however, governmental control, economic legislation and planning ground themselves on different aspects of welfare, that are being expressed and measured quantitatively, but are nevertheless sought to be sternly demarcated in the rigidly positive theory. The wide-spread vogue of economic planning, to the aim and technique of which many orthodox economists now subscribe, has introduced a trenchant discussion on the relations between economic theory and economic policy, and on the methodology of economics and the social sciences in general both in England and the U. S. A., following a similar controversy in Germany about three decades back. The opposed stand-points and methods of approach in economics are being presented to-day as irreconcilable, antithetical dogmas. Meanwhile changes in the canons of thought in contemporary biology and philosophy which have drawn the various other social sciences together, obscuring their distinctive boundaries, have increased the ideological gap between different schools of economics,—a gap which remains hardly analysed. Yet no doubt in order that the central core of economic thinking may not shrivel from the dry light of contemporary thinking about life, mind and society, economics must now find a place for the study not only of scarce resources and population, prices and costs, but also of the changing framework of law, public opinion and economic institutions and the interaction between economic and political power and of the relations between economic and other social values and the order of values, virtues and rights in the contrasted theories of institutions, from which alone the true meaning and trend of eco-

conomic life can be derived. The gulf between economic theory and economic policy, between price economics and welfare economics can also be bridged by a recognition of certain social norms in the form of economic rights, and the formulation of certain objective conditions as indicative of the measure in which the economic system serves as a means to the integrated system of social values. As the older liberal capitalism can no longer withstand the challenge of collectivisation, the latter brings to the fore the significance of a theory of basic economic and political rights and freedoms of individuals. For the issue of applied economics is no longer the choice between monopoly capitalism and socialism, but between totalitarian planning, which destroys those democratic controls without which efficiency is bound to turn into exploitation, and democratic planning fully cognisant of the fundamental personal Rights of Man, which have been the gift of the liberal Christian order to the world. These are issues in economic policy and planning from which there can be no escape in both war and peace.

This volume is intended as a contribution towards the reorientation of methods and concepts of economics on relativistic and institutional foundations and towards a co-operation in the social sciences, which might re-establish economic theory on the broad, humane path of the early masters to which the contemporary trends in ethics and philosophy also invite economics.

This study originated in a presidential address delivered before the Indian Economic Association (1933) in which I sketched a theory of economic sociology and of relativity of economic environments, relations and norms. Earlier in my *Principles of Comparative Economics* (1922) and *Borderlands of Economics* (1925) I stressed the regional and institutional background of economic theory and its re-orientation so as to bring it in line with recent advances in human ecology, anthropology and psychology. Several chapters dealing

with methods and inter-relations between economics and other social sciences were also offered as lectures in the Universities in Europe and America in 1937. My thanks are due especially to the Universities of Cambridge and Oxford, and the Institute of Sociology in Great Britain, the Universities of Cologne, Prague and Vienna on the Continent, and of the Columbia University, New York, and the Universities of Chicago, Wisconsin, Minnesota and Michigan in the U.S.A. for the opportunity I obtained for presenting the aims and methods of ecological and institutional economic theory. Recently the University of Delhi have laid me under obligation by inviting me to deliver a course of Readership Lectures under the Sir Kikabhai Premchand endowment. I owe acknowledgments also to Prof. C. J. Broad and Mr. D. H. Robertson of Cambridge, Prof. Ernest Barker of Oxford, Prof. Adolf Weber of Heidelberg, Prof. Othmar Spann of Vienna, Prof. F. H. Knight of Chicago and Prof. J. W. Commons of Wisconsin for valuable discussions relating to the present scientific status and scope of economics and its relations to the other social sciences. To my pupil, Mr. Sushil Chandra, I am indebted for aid in the preparation of the index.

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