

# INSTITUTIONAL ECONOMICS

ITS PLACE IN POLITICAL ECONOMY

BY

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## PREFACE

This book is modeled upon textbooks in the Natural Sciences. Each idea here incorporated is traced back to its originator, and then the successive modifications of that idea are developed and the earlier double or treble meanings of the idea are separated, until each, as a single meaning, is combined with the others in what I conceive to be the Science of Political Economy as it is developing since the last Great War. The originators of new ideas and theories have appeared before and after revolutionary wars, during what I call the War Cycle. Since I base my analysis on the Anglo-American common law, I begin with the English Revolution of 1689; then follows the World War of the French Revolution, 1789; then the American Revolution of 1861, an outcome of the suppressed European revolution of 1848; then the war of a dozen revolutions beginning 1914.

As I have explained elsewhere in my autobiography, I have been a part of two of these revolutionary cycles: the American, which abolished slavery, and the world revolutions of the past twenty years. My first book, *The Distribution of Wealth* (1893), was dominated by the theories prevailing during the last quarter of the Nineteenth Century; my *Legal Foundations of Capitalism* (1924) and this *Institutional Economics* (1934) are dominated by the theories emerging in the revolutionary cycle of which we now are a part.

Among the many students and assistants from whom I have derived much during the past twenty-five years, Mrs. Anna Campbell Davis has assisted me on legal and economic cases during seven years, and Mr. Reuben Sparkman on economic cases during four years. My colleagues in the Department of Economics have given me invaluable help, and other economists, including former and present students, to whom I have submitted manuscripts in my writing and rewriting, have picked out flaws and helped me over difficulties.

JOHN R. COMMONS

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# INSTITUTIONAL ECONOMICS

## CHAPTER I

### THE POINT OF VIEW

My point of view is based on my participation in collective activities, from which I here derive a theory of the part played by collective action in control of individual action. The view may or may not fit other people's ideas of institutional economics. The comments and criticism by readers and students of both my *Legal Foundations of Capitalism* and the various mimeographed copies and revisions of this book on Institutional Economics, to the effect that they could not understand my theories nor what I was driving at, and that my theories were so personal to myself that perhaps nobody could understand them, leads me to set aside personal inhibitions and boldly to treat myself as an Objective Ego, participating, for fifty years, in many forms of collective action.

In this first chapter, and again in the section on accidents and unemployment,<sup>1</sup> I set forth a record of this participation. I hold that this book is not so much a theory personal to myself as it is a theory conforming to many experiments in collective action and requiring therefore a reconciliation with the individualistic and collectivistic theories of the past two hundred years.

My participation began with my membership, in 1883, in the local typographical union of Cleveland, Ohio. I came to the job with all the naïveté and curiosity of a "country printer" who had obtained the all-round training of seven years in a small newspaper and job office in a small village of rural Indiana. This new experience of working twelve hours a day, seven days a week for about \$15 per week, and the efforts of the union to control both the employer and printers of a great daily newspaper, and then my travels as a tramp printer, prior to 1886, converted me from a vague idea of preparing myself for journalism into a plan of studying the whole problem of economics in every direction that I could.

My first reading in economic theory was Henry George's individualistic and theological *Progress and Poverty*, recommended to

<sup>1</sup> Below, p. 2.

me by a fellow-printer. I never was able to reach conclusions deductively, as George had done. I resented his condemnation of trade unions,<sup>2</sup> which, in my own case, I knew resulted in conditions of employment preferable to those existing in the open shop across the way.

My first introduction to the problem of the relation of law to economics was in the classes of Professor Ely<sup>3</sup> at Johns Hopkins University, 1888. In 1899 I investigated, for the United States Industrial Commission, the subject of Immigration, which took me to the headquarters of practically all the national trade unions. This led to a further investigation of restrictions of output by capitalistic and labor organizations. After 1901 I participated in labor arbitration with the National Civic Federation, representing "labor, employers, and the public," and, in 1906, with the same organization, in an investigation of municipal and private operations of public utilities.

In 1905 I drafted a civil service law and in 1907 a public utility law at the request of Governor Robert M. La Follette of Wisconsin. The public utility law was designed to ascertain and maintain reasonable values and reasonable practices by the local public utility corporations. In 1906 and 1907, I investigated with others, for the Russell Sage Foundation, labor conditions in the steel industry at Pittsburgh. During 1910 and 1911, when the Socialists were in control of the city of Milwaukee, I organized for them a Bureau of Economy and Efficiency. In 1911 I drafted, and then participated for two years in the administration of, an Industrial Commission law for the state of Wisconsin, with the purpose of ascertaining and enforcing reasonable rules and practices in the relations between employers and employees. From 1913 to 1915 I was a member of the Industrial Relations Commission appointed by President Wilson. In 1923 Professor Fetter, Professor Ripley, and I represented four Western states before the Federal Trade Commission on the Pittsburgh Plus case of discrimination practiced by the United States Steel Corporation.

In 1923 and 1924, as president of the National Monetary Association, I investigated the workings of the Federal Reserve system in New York and Washington. This was followed, in 1928, by aid given to Congressman Strong of Kansas on his price stabilization bill before the House Committee on money and currency.

<sup>2</sup> George, Henry, *Progress and Poverty* (1879). Reference to his *Complete Works* (1906-1911).

<sup>3</sup> Cf. Ely, Richard T., *Property and Contract in Their Relation to the Distribution of Wealth* (2 vols., 1914).

Meanwhile, between 1924 and 1926, I administered for two years, as chairman, a voluntary plan of unemployment insurance in the clothing industry of Chicago. This plan was similar to that which I had previously devised, in 1923, for legislation. The plan, with improvements, was finally enacted into law in Wisconsin in 1932.

I do not see how any one going through these fifty years of participation in experiments could fail to arrive at two conclusions: conflict of interests and collective action. Even the state and city turned out to be collective action of those who were in possession of sovereignty.<sup>4</sup>

Meanwhile, I was necessarily studying hundreds of decisions, mainly of the United States Supreme Court and of Labor and Commercial Arbitration tribunals, endeavoring to discover on what principles these tribunals decided disputes of conflicting interests—the Court acting under the clauses of the Constitution relating to due process of law, to the taking of property and liberty, and to equal protection of the laws. These decisions were discussed in my *Legal Foundations of Capitalism* (1924), to which the present volume is a related study of the theories of economists. I found that few of the economists had taken the point of view here developed, or had made contributions that would make it possible to fit legal institutions into economics or into this constitutional scheme of American judicial sovereignty.

The main thing which I noticed, while working with the lawyers in drafting a public utility law in 1907, was the change effected by the Supreme Court of the United States, after 1890, in the meaning of the word "property." The change added to the earlier meaning of "corporeal" property in the Slaughter House Cases, 1872, and the Munn Case, 1876, the new meaning of "intangible" property which the Court gave to the word property after 1890. The additional meaning was rounded out by several decisions between 1897 and 1904.

The meaning of intangible property, according to these decisions, and as I have further developed its meaning since the publication of my *Legal Foundations of Capitalism*, is: the right to fix prices by withholding from others what they need but do not own. Intangible property also includes the meaning of liberty, which previously was treated separately. All Court decisions since 1890 on reasonable value will be found to have turned on this meaning of intangible

<sup>4</sup> I am permitted by the editor of the *American Economic Review* to use an article in the June number, 1932, as the substance of what follows. See also the comments by Professor Joseph E. Shafer, in an earlier number of the same *Review*, which have led me to state this personal point of view.

property and the corresponding conflicts of interest coming before the courts.

Thorstein Veblen, to his great credit, was introducing the same idea of intangible property into economics during the period following 1900, and it was mainly on that ground that he became known as an "institutional" economist. But the difference was that Veblen obtained his case material from the testimony of financial magnates before the United States Industrial Commission of 1900, so that his notion of intangible property ended in the Marxian extortion and exploitation. But my sources were my participation in collective action, in drafting bills, and my necessary study, during these participations, of the decisions of the Supreme Court covering the period; so that my notion of intangible property ends in the common-law notion of reasonable value.

On analyzing this notion, not only in Supreme Court cases but also in collective bargaining, labor arbitration and commercial arbitration cases, I discovered that, of course, the decisions of these tribunals began with conflict of interests, then took into account the evident idea of dependence of conflicting interests on each other; then reached a decision by the highest authority, the Supreme Court or the labor and commercial arbitration courts, endeavoring to bring—not harmony of interests—but order out of the conflict of interests, known by the Court as "due process of law."

Meanwhile I was trying to find what could be the unit of investigation which would include these three constituents of conflict, dependence, and order. After many years I worked out the conclusion that they were found combined together only in the formula of a *transaction*, as against the older concepts of commodities, labor, desires, individuals, and exchange.

So I made the transaction the ultimate unit of economic investigation, a unit of transfer of legal control. This unit enabled me to classify all the economic decisions of the courts and arbitration tribunals under the variable economic factors involved in transactions as they actually are made. This classification permitted an historical development, showing how it was that the courts, as well as arbitration tribunals, ruled out what they deemed, at the time, to be coercive and unreasonable values arrived at in transactions, and approved what they deemed, under the circumstances, to be persuasive transactions and reasonable values.

Going back over the economists from John Locke to the orthodox school of the present day, I found that they held two conflicting meanings of wealth, namely: that wealth was a *material* thing, and again that it was the *ownership* of that thing. But ownership, at

least in its modern meaning of intangible property, means power to *restrict* abundance in order to maintain prices; while the material things arise from power to *increase* the abundance of things by efficiency in production, even in overproduction. Hence, ownership becomes the foundation of institutional economics, but material things are the foundations of the classical and hedonic economics, whose "corporeal" meaning of property was equivalent to the material thing owned.

Not until it became vaguely felt by the heterodox economists in the middle of the Nineteenth Century—such as Marx, Proudhon, Carey, Bastiat, MacLeod—that ownership and materials were not the same thing, were the beginnings laid for institutional economics. These economists were vague in that they had the older idea of "corporeal" property (even yet retained by economists), which identifies ownership with the materials owned, or distinguishes only "corporeal property" from the "incorporeal property" which is contract, or debt. Hence, it was not until the new idea of "intangible property" arose out of the customs and actual terminology of business magnates in the last quarter of the Nineteenth Century that it was possible for Veblen and the Supreme Court to make the new distinctions which clearly separate from each other not only the ownership of materials and the ownership of debts, but also the ownership of expected opportunities to make a profit by withholding supply until the price is persuasively or coercively agreed upon. This ownership of expected opportunities is "intangible" property.

Thus, institutional economics consists partly in going back through the court decisions of several hundred years, wherein collective action, not only by legislation but also by common-law decisions interpreting the legislation (culminating in the common-law method of the Supreme Court of the United States), takes over, by means of these decisions, the customs of business or labor, and enforces or restrains individual action, wherever it seems to the Court favorable or unfavorable to the public interest and private rights.

Such an interpretation also consists in going back through the writings of economists from John Locke to the Twentieth Century, to discover wherein they have or have not introduced collective action. Collective action, as well as individual action, has always been there; but from Smith to the Twentieth Century it has been excluded or ignored, except as attacks on trade unions or as postscripts on ethics or public policy. The problem now is not to create a different kind of economics—"institutional" economics—divorced from preceding schools, but how to give to collective action, in all its varieties, its due place throughout economic theory.

In my judgment this collective control of individual transactions is the contribution of institutional economics to the whole of a rounded-out theory of Political Economy, which shall include and give a proper place to all the economic theories since John Locke, who first laid the theoretical foundations for the labor theories of value and for modern capitalism.

The first of the economists to make conflict of interests universal in economics was David Hume in his theory of *scarcity*, rather than Locke and Smith in their theory of divine *abundance*. But Hume, followed by Malthus, also made scarcity the basis of coöperation, fellow feeling, justice, and property: If there were unlimited abundance of everything there would be no self-interest, no injustice, no property rights, no ethics.

It is only scarce things, actual or expected, that are wanted and desired. Since they are scarce, the acquisition of them is regulated by the collective action which creates the rights and duties of property and liberty without which there would be anarchy. Since this scarcity is a fact recognized by economists, they have already presupposed the institution of property in their very concepts of wants and desires. Institutional economics openly avows scarcity, instead of taking it for granted, and gives to collective action its proper place of deciding conflicts and maintaining order in a world of scarcity, private property, and the resulting conflicts.

I make conflict of interests predominant in transactions. But I conclude that this cannot be allowed to be the only principle, because there are also mutual dependence and the maintenance of order by collective action. I start, like economists, with scarcity, as universal for all economic theory. Then I proceed, as did Hume and Malthus, to show that out of scarcity derives not only conflict, but also the collective action that sets up order on account of mutual dependence.

Order, or what I call working rules of collective action, a special case of which is "due process of law," is itself quite changeable in the history of institutions; and I find this order concretely represented in the various rationing transactions, which would be needless in a world of abundance.

It is for this reason of scarcity that I make efficiency also a universal principle, because it overcomes scarcity by coöperation. But coöperation does not arise from a *presupposed* harmony of interests, as the older economists believed. It arises from the necessity of *creating a new harmony* of interests—or at least order, if harmony is impossible—out of the conflict of interests among the hoped-for coöperators. It is the negotiational psychology of persuasion, coer-

cion, or duress. The greatest American piece of actual coöperation, latterly under ill repute, is the holding companies which suppress conflicts, if persuasion proves inadequate. A more universal coöperation, suppressing conflict in behalf of order, is proposed by Communism, Fascism, or Nazism. These have found their own way of submerging conflicts of interest. Hence, harmony is not a presupposition of economics—it is a consequence of collective action designed to maintain rules that shall govern the conflicts.

All that Communism, Fascism, or Nazism needs to abolish historic capitalism is to abolish bargaining transactions and to substitute for them the managing and rationing of a planned economy.

This is why I relegate the classical and communistic engineering economics and the Austrian home economics to the *future*, and develop a negotiational psychology as the present transfer of legal control to take effect in the future production, consumption, or labor process. Production and consumption cannot be carried on without first obtaining legal control. Possibly this changes the idea of causation. It places causation definitely in the future instead of in the past, where it was placed by the labor theories of Locke and the classical and communist economists; or instead of in the present sensations of pain and pleasure of production or consumption of the hedonic economists since the time of Bentham. It becomes a *volitional* theory of future consequences of present negotiations and transfers of legal control, determining whether production shall go on or slow down or stop, or determining the extent to which future consumption will be expanded or contracted or pauperized.

Perhaps the question turns on the *kind* of psychology implied in the terms, wants and desires. If I look at or participate with people actually engaged in transactions—as do the courts when they analyze or impute motives to disputants—I find futurity always there, not in production or consumption, but in the persuasions or coercions of bargaining transactions, the commands and obedience of managerial transactions, and the arguments and pleadings of rationing transactions, which will ultimately determine production and consumption. In these negotiations and decisions, which are of the essence of institutional economics, it is always *future* production and *future* consumption that are at stake, because the negotiations determine the legal control which must precede physical control.

If this negotiational psychology, as others have alleged, changes the whole problem of causation in economics and the whole of all the definitions of wants and desires, I can only say that it is what actually is there and should be incorporated as one of the multiple causations to be watched by economists. I think this is being done;



but when the older schools and their modern strict conformists worked out their theories they tried to select a single principle of causation, like labor or desire, whereas modern theories are certainly theories of multiple causation. Hence I do not think that "institutional causation" excludes other causations; but it is the volitional economics which operates in all kinds of transactions which always look forward to future consequences. Institutional economics takes its place as the proprietary economics of rights, duties, liberties, and exposures, which, as I shall endeavor to show throughout, give to collective action its due place in economic theorizing.

I do not see that there is anything new in this analysis. Everything herein can be found in the work of outstanding economists for two hundred years. It is only a somewhat different point of view. The things that have changed are the interpretations, the emphasis, the weights assigned to different ones of the thousands of factors which make up the world-wide economic process. All of these are traceable to the dominant political and economic problems by which economists were faced at the time and place in which they wrote, and to their different social philosophies in the changing conflicts of interest of two centuries.

What I have tried to do is to work out a system of thought that shall give due weight to all economic theories, modified by my own experience. This would have been impossible except for my past thirty years in this thrilling state of Wisconsin, with two such leaders as Robert M. La Follette, the individualist, and Victor Berger, the socialist, and with the generosity of its people in supporting this magnificent University. Wisconsin is a miniature of world-wide conflicts of interest and of efforts to obtain by investigation reasonable values and reasonable practices out of economic conflict. The effort would have been impracticable without the continuance of the early civil service law insisted on by Governor La Follette, which has recently been jeopardized by the incoming Democrats. The initiative of the state, however, has been restrained, partly by decisions of the Supreme Court of the United States, partly by national administrative bodies taking jurisdiction of state affairs, and recently by the unprecedented nationalistic experiments in which all of us are now participating.

I confess that this book is burdened by much repetition. But this I could not help, partly on account of unfamiliarity of students and readers with the novelty of the subject and partly because, in a theory that gives due weight to the many sources of multiple causation, a single concept or principle recurs at every point where one or the other many changeable causes infringe. If a preceding cause,