Economics and Institutions

A Manifesto for a Modern Institutional Economics

GEOFFREY M. HODGSON



Polity Press

Preface Acknowledgements		ix
		xvii
	PART ONE – PRELUDE	1
1	Introduction and Outline	3
	1.1 The trajectory of critical development	4
	The current theoretical background	4
	Problems of information	5 7
	1.2 Some observations	
	Subjectivism and institutionalism	7
	Process and system ./	8
	Determinism, purposefulness and choice	10
	1.3 A systems view	12
	The endogeneity of preferences and technology	13
	The systems view briefly explored	18
	Economics and the systems view	19
	1.4 Scope and outline	21
	The fate of institutional economics	21
	Outline of this work	24
2	On Methodology and Assumptions	27
	2.1 The methodological defence of neoclassical theory	. 28
	Friedman's methodology	29
	The methodology in practice	30
	Criticisms of Friedman	32
	The instrumentalist interpretation	33
	2.2 Empiricism and beyond	35
	A critique of positivism and empiricism	35
	The falsificationism of Sir Karl Popper	37

	A critique of Popper's methodology	3
	2.3 The fate of methodology	4:
	Prediction and other obsessions	42
	The limits of prescriptive methodology	4.
	The remaining scope for appraisal	4
	The residual function of evidence	4′
	2.4 Appendix: Friedman and the maximization hypothesis	43
	PART TWO - A FAREWELL TO 'ECONOMIC MAN'	5
3	Behind Methodological Individualism	5
	3.1 What is methodological individualism?	5:
	Debating methodological individualism	5:
	Purposeful human action	5
	Causality and purpose	5
	Psychological explanations of purpose	6
	3.2 Critique and implications	6
	Spontaneity and absentee explanation	6.
	The problem of infinite regress	6
	Wholes and parts	6
	Concluding remarks	7
4	The Maximization Hypothesis	7
	4.1 The utility of criticizing the maximization hypothesis	7
	Revealed preference and beyond	7
	The 'evolutionary' argument	7
	Other theoretical critiques of maximization	7
	Empirical critiques of maximization	8
	Evaluations of the criticisms	8
	4.2 Problems with the means-ends framework	9
	Ends and means	9
	Adaptive ends	9
5	The Rationalist Conception of Action	9
	5.1 Initial criticisms	10
	Early critiques	10
	Reason and discourse	10
	A possible rationalist response	10
	5.2 Cognition and the hierarchy of mind	10
	Unconscious processes	10
	Cognitive theory	10
	Multiple levels of consciousness	10
	Too little information and too much	- 11

	5.3 Concluding remarks	114
	The rationalist dilemma	114
	Conclusion	115
6	Action and Institutions	117
	6.1 The impact of cognitive theory	118
	Cognition, culture and society	118
	Cognitive theory and subjectivism	121
	6.2 The significance of institutions	123
	Action and institutions	123
	Habits	124
	Routinization and institutions	130
	Routines, institutions and information	131
	Orthodoxy and institutions	134
	Game theory and institutions	134
	Spontaneous order	137
	6.3 Some conclusions	. 138
	The potential for cumulative instability	138
	The evolutionary character of institutional economics	140
	PART THREE – ELEMENTS OF AN	
	INSTITUTIONAL ECONOMICS	145
7	Contracts and Property Rights	147
	7.1 The concepts of exchange and property	148
	Defining exchange	148
	Exchange and institutions	149
	Individualistic conceptions of property and law	151
	Williamson's treatment of exchange	154
	7.2 Critique of the utilitarian calculus	156
	Durkheim and the impossibility of pure contract	157
	Some special cases of impure contract	160
	The centrality of impure contract	162
	General remarks on trust	166
	7.3 The impurity principle and the fate of capitalism	167
	Impurity and Cartesian thinking	168
	Contractual impurities: Schumpeter and Marx	169
8	Markets as Institutions	172
	8.1 Defining the market	172
	The elusive definition	172
	Markets and institutions	173
	Types of market institution	176

	Markets and exchange	177
	Some immediate theoretical consequences	177
	8.2 Why do markets exist?	179
	Transaction costs	180
	On the limits to the growth of the market	183
	8.3 Markets, prices and norms	182
	The establishment of norms	184
	The classical tradition	186
	8.4 The impossibility of perfect competition	187
	The function of conventions	188
	The game-theoretic analysis of markets	191
9	Firms and Markets	195
	9.1 Neoclassical perspectives on the firm	196
	Alchian and Demsetz: the firm as a market	196
	Why do firms exist?	199
	Transaction costs and lack of information	201
	9.2 Notes towards an alternative perspective	203
	Uncertainty and transaction costs	203
	Uncertainty, institutions and the firm	203
	The comparative efficiency of the firm	208
	Innovation and transaction costs	212
	Efficiency, technology and power	213
10	Expectations and the Limits to Keynes	217
	10.1 Expectations in the General Theory	218
	Long-term expectations	218
	Keynes' policy conclusions	220
	10.2 Some limitations of the theory	223
	The expecting agent	222
	Firms and financiers	223
	Keynes' rationalist conception of action	226
	Government action	228
	10.3 Austrian and rational expectations alternatives	230
	The endogeneity of expectations	230
	The rational expectations hypothesis	231
	The Austrian theory of expectations	236
	10.4 Lessons for post-Keynesian economics	239
	The imperfectionist interpretation	240
	Conclusion	243
11	Direction and Policy Implications	242
	11.1 Needs and welfare	243

	A road to serfdom?	243
	Needs and economic analysis	245
	Theories of needs	247
11	.2 Systems, impurity and dominance	252
	Economic systems as diversified pluralities	254
	The principles of impurity and dominance	256
	Cybernetics and the impurity principle	257
	Illustrations of the impurity principle	258
	Extending the impurity principle	261
11	1.3 Guidelines for economic organization	262
	The firm as a system	262
	The conditions for innovation	267
	Institutional intervention	269
Notes		275
Bibliography		306
Index of Names		347
Index (356	