New lamps for old? Why Veblen beats the Nobel Laureates

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The Editors of *Focaal* asked me to comment on the recent award of a so-called Nobel Prize in economic sciences to Oliver Williamson, a founder of New Institutional Economics (NIE), and Elinor Ostrom, a political scientist who is best known for her work on "common property regimes" and "public entrepreneurs." The committee of the Bank of Sweden commended the two of them for their work on "economic governance," which has reshaped how economists think about the nature of the firm and the boundaries between private and public institutions.

Three decades of deregulation have called into question the old verities about public and private sectors. The rising power of corporations and weakening of the state's economic role have led to a shift of many public functions toward the former (corporate social responsibility). At the same time, a rhetoric of community has taken hold, backed by an array of hybrid actors—NGOs, the third sector, social entrepreneurs, social capital—to fill the void left by deregulation. The economic crisis of 2008/9 was an occasion for the economics profession to recognize, through the work of Williamson and Ostrom, that the neoclassical paradigm had indeed been evolving to accommodate this blurring of the public/private distinction. Similarly, the previous year's award to the macro-economist Paul Krugman acknowledged the temporary swing back to state intervention in the economy, if only with the aim of rescuing the banks.

Implicit in the request to write about this award was a question: Is this a sign that the economics profession will in future be more open to the kind of work that anthropologists do? My answer has to be "no." NIE has served mainly to extend the logic of mainstream economics into areas that might not previously have been considered suitable territory and in the process has shored up the latter's claim to universality. In other words, it is a species of intellectual imperialism, not an opening to more critical perspectives. This point can be made most clearly by comparing NIE with the founders of institutional economics. Most readers are familiar at some level with *The great transformation* (1944), whose author, Karl Polanyi, brought a version of the institutional approach to economic anthropology in the 1950s. But the true founder of institutional economics was Thorstein Veblen, a midwesterner of Scandinavian descent (like Ostrom), from whose prolific oeuvre I select *The theory of business enterprise* (1904) to show how far NIE departs from his critical historical approach. Politically, they are as chalk and cheese.

Karl Polanyi

Polanyi's masterpiece, *The great transformation: The political and economic origins of our times* ([1944] 2001), was written toward the end of a period in world history (1914–45) so dire that Winston Churchill called it "the second thirty

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years war." It opens with a highly selective account of the making of world society in the nineteenth century, a society that Polanyi not unreasonably considered to be lying in ruins as he wrote. Money was a central feature of all four pillars of this civilization. Polanyi identified the interest that had sustained a century of peace with what he insisted on calling *haute finance,* "an institution *sui generis,* peculiar to the last third of the nineteenth and the first third of the twentieth century, [which] functioned as the main link between the political and economic organization of the world in this period" (Polanyi [1944] 2001: 10).

The international gold standard "was merely an attempt to extend the domestic market system to the international field"; the balance-of-power system was a superstructure built on its foundation; and the gold standard's fall "was the proximate cause of the catastrophe" (3).

The self-regulating market was "the fount and matrix of the system"; it had "produced unheard-of material welfare," but it was utopian in its pursuit of an autonomous circuit of commodities and money. The liberal state, in the name of market freedom, forced all other interests in society to submit to the freedom of capital, another word for money.

Later in the book, Polanyi listed money as one of the three "fictitious commodities." Labor, land, and money are essential to the industrial system; they must therefore be bought and sold, but they were definitely not produced for sale. Labor is human activity that is part of life itself; land is another word for nature; and "actual money is merely a token of purchasing power which, as a rule, is not produced at all, but comes into being through the mechanism of banking or state finance" (72). Here Polanyi comes close to suggesting that a free market in money entails buying and selling society itself. Consistent with this approach, Polanyi inverts the liberal myth of money's origin in barter:

"The logic of the case is, indeed, almost the opposite of that underlying the classical doctrine. The orthodox teaching started from the individual's propensity to barter; deduced from it the necessity of local markets, as well as of division of labour; and inferred, finally, the necessity of trade, eventually of foreign trade, including even long-distance trade. In the light of our present knowledge [e.g., Thurnwald, Malinowski, Mauss], we should almost reverse the sequence of the argument: the true starting point is long-distance trade, a result of the geographical location of goods and of the 'division of labour' given by location. Long-distance trade often engenders markets, an institution which involves acts of barter, and, if money is used, of buying and selling, thus, eventually, but by no means necessarily, offering to some individuals an occasion to indulge in their alleged propensity for bargaining and haggling" (58).

Money and markets thus have their origin in the effort to extend society beyond its local core. Polanyi believed that money, like the sovereign states to which it was closely related, was often introduced from outside; and this was what made the institutional attempt to separate economy from politics and to naturalize the market as something internal to society so subversive.

Polanyi distinguished between "token" and "commodity" forms of money.[1] "Token money" was designed to facilitate domestic trade, "commodity money" foreign trade; but the two systems often came into conflict. Thus the gold standard sometimes exerted downward pressure on domestic prices, causing deflation that could only be alleviated by central banks expanding the money supply in various ways. The tension between the internal and external dimensions of economy often led to serious disorganization of business (193–94). Another way of putting this contradiction is to oppose the liberal definition of money as just a "medium of exchange" to one as a "means of payment." Money was thus, "not a commodity, it was purchasing power; far from having utility itself, it was merely a counter embodying a quantified claim to things that could be purchased. Clearly a society in which distribution depended on possession of such tokens of purchasing power was a construction entirely different from market economy" (196).

Here Polanyi echoes Keynes's contrast between "money proper" (medium of exchange) and "money of account" (unit of account and means of payment), with the emphasis on the latter, similarly drawing attention to the political possibilities for state manipulation of "purchasing power."

The final collapse of the international gold standard was thus one consequence of the ruinous attempt to delink commodity and token forms of money. In a trenchant discussion of the economic crisis of the 1930s that has echoes of the world economy today, Polanyi highlighted the separation of the money system from trade. As restrictions on trade grew, money became freer:

"Short-term money moved at an hour's notice from any point of the globe to another; the modalities of international payments between governments and between private corporations or individuals were uniformly regulated … In contrast to men and goods, money was free from all hampering measures and continued to develop its capacity to transact business at any distance at any time. The more difficult it became to shift actual objects, the easier it became to transmit claims to them … The rapidly growing elasticity and catholicity of the international monetary mechanism was compensating, in a way, for the ever-contracting channels of world trade … Social dislocation was avoided with the help of credit movements; economic imbalance was righted by financial means" (205–6).

But in the end, political means of settling the imbalance outweighed market solutions and war was the result.

Polanyi concluded in his notes to *The great transformation* that "money is not a decisive invention; its presence or absence need not make an essential difference to the type of economy … Money, like markets, is in the main an external phenomenon, the significance of which to the community is determined largely by trade relations" (276–77).

When he returned to the subject, as an American academic after the war, much of his polemical intensity had been replaced by a more dispassionate concern to launch the comparative study of pre-industrial economies by anthropologists and historians. In "Money objects and money uses" ([1964] 1977), Polanyi approaches money as a semantic system, like language and writing. His main point is that only modern money combines the functions of payment, standard, store, and exchange and this gives it the capacity to sustain the set of functions through a limited number of "all-purpose" symbols. Primitive and archaic forms attach the separate functions to different symbolic objects, which should be considered to be "special-purpose" monies. Here too Polanyi is arguing against the primacy of money as a medium of exchange and for a multi-stranded model of its evolution. There is no sense now, as there was in his passionate war-time book, that the future of civilization depends on getting this question right.

The Columbia project, a collaborative vehicle for Polanyi's retirement, matured as publication of *Trade and market in the early empires* (1957). By now the crusading zeal of *The great transformation* had been replaced by a wary compromise. In "The economy as an instituted process" (Polanyi 1957), he took Carl Menger's two types of economic rationality—the "formal" and the "substantive"—as a basis for an academic division of labor in which the economists got to use their formal methods to explain the abstract markets of industrial societies and the anthropologists and the historians were left to study the rest, where a substantive concern with material survival was said to hold sway. This was not where institutional economics was supposed to end up, but there was a Cold War going on and who can blame Polanyi for choosing a quiet life in old age?

The 1940s did indeed see a world revolution. It was not one foreseen by Karl Polanyi. Yet interest in his work has never been greater than now and this may be related to his prophetic value in the present crisis of world economy. Because the last three decades have seen a replay of the "self-regulating market" scenario and possibly the beginning of its demise, Polanyi's vision offers one perspective on the political and economic origins of our own times.

Thorstein Veblen

America's place in the evolution of Western economy, its distinctiveness and centrality, is poorly understood. European synthesizers after Tocqueville have known little about the United States; and Americans, having escaped from the old regime and in a sense from history itself, prefer to think of themselves as rational individual agents making life anew. The American century, the twentieth, produced few great works of historical synthesis (which is one reason why Polanyi's stands out); consequently, we are poorly placed to assess the period of US hegemony since 1945. Karl Marx believed that the Yankee version of industrial capitalism was a purer and more progressive form than Britain's and he justly celebrated the American Civil War as a decisive phase in the global bourgeois revolution. Moreover, not only was Locke's political philosophy given its most systematic application in the American constitutional experiment, but American economists—ever since Irving Fisher turned the old (verbal) quantity theory of money into an equation (MV = PT)—have far transcended their English and European counterparts in the use of mathematical techniques. Just as the relationship between England and the rest of Europe remains to be clarified so too does America's contribution to the idea and practice of economy.

The decades leading up to World War I saw a fundamental shift in the social organization and technology of industrial economies. We will never make sense of our own times unless, with all the benefits of hindsight, we grasp fully what happened then. Fortunately we have a wonderful analysis of the making of the twentieth century in Thorstein Veblen's *The theory of business enterprise* (1904), a work that is less well-known than his notorious *The theory of the leisure class* (1899), but is better-known than his masterpiece, *Imperial Germany and the industrial revolution* (1915 [2006]). The value of *The theory of business enterprise* for us is that its focus is on modern America. Marx first drew attention to the importance of machines in modern development. Veblen, a half-century later and with the robber barons operating right under his nose, saw how machine production could be hijacked by financial speculators. He recognized the extraordinary implications of the recent legal fiction that would treat huge corporations as if they were individual persons with the natural rights of ordinary citizens. At the same time, he revealed how "captains of industry" were able to pile up personal fortunes at the expense of society's real interests while hiding behind this fiction. He was scornfully derisive of the intellectually backward and self-serving platitudes of the economics profession. Explaining why economics did not deserve to be recognized as an "evolutionary science," he proposed instead to remake it as the study of institutions. No doubt he would have his own interpretation of the rise of neoclassical economics to the virtual standing of a world religion since World War II.

Veblen saw a fundamental contradiction between the social discipline imposed by machine production and the motives of businessmen who controlled the industrial system through their ability to make money by selling things. Businessmen promote any useless activity, as long as it brings a profit; they do not care about production or livelihood as such. Consequently, power in industry had passed from the factory floor to the financial managers at head office. The cultural system of business enterprise originated in seventeenth-century England, which he described as "an isolation hospital for technology, science and civil rights." Its foundation is the institution of private ownership—the idea that free labor should own the product of its workmanship as a "natural right." The system of market competition laid out in the eighteenth century by Adam Smith was based on handicrafts and its philosophy was pre-industrial. Machine production transformed the nineteenth-century economy and developments in the legal forms of corporate capitalism were rapidly reorganizing the logic of business enterprise in Veblen's day.

Yet economists still persevered with a pre-industrial myth of economy ("a conventional anthropomorphic fact") that was as relevant to understanding the modern world as Newtonian

mechanics or the artisan's notion of God as a creator. The organization of machine industry had de facto removed natural rights long ago. Its culture is skeptical, matter-of-fact and relativistic; modern science reflects this attitude. The spirit of pecuniary gain that motivates modern businessmen (slavishly endorsed by the economics profession) cannot be reconciled with the material and social needs of machine industry. Veblen predicts that the idea of the economy as free market competition is a transitory halfway house on the road either to socialism based on machine production or to a new barbarism, dynastic politics conducted along medieval lines, with war and games the principal preoccupations of the ruling class.

This was not the message that twentieth-century Americans wanted to hear and Veblen's institutional economics was swiftly sidelined into the margins of academia. He got his own back on the universities in a brilliant 1918 work, *The higher learning in America: A memorandum on the conduct of universities by businessmen.* The field he sought to establish made a comeback during the Great Depression, by the end of which institutional economists outnumbered the neoclassical variety by 3 to 1. It did seem after all more relevant to devise regulations for industry and banking than to produce abstract models of perfect markets. John R. Commons's *Institutional economics* (1934) was the foundational text of this movement; and the publication of Clarence Ayres's *The theory of economic progress* in the same year as *The great transformation* (1944) turned out to be its apogee. Paul Krugman argues that institutional economics failed to solve the problems posed by the Great Depression. In any case, World War II not only revived the economy, it spawned new approaches to the management of complex systems, such as Operations Research. As Philip Mirowski shows in *Machine dreams* (2001), neoclassical economics, bolstered by new computing techniques and the nurturing environment of the Cold War, took off from there on its inexorable rise to public dominance.

Veblen's fundamental critique of orthodox economics as a mathematical mystification of an outmoded pre-industrial ideology fell on deaf ears at the time and has been largely forgotten since. Clifford Geertz made the same point in two studies of the *suq* (bazaar economy) at opposite ends of the Islamic world—*Peddlers and princes* (1963) and *Order and meaning in Moroccan society* (Geertz et al. 1979)—where he observed that modern economics reinvented itself as the competitive individualism of the bazaar just when an unholy alliance of governments and corporations were installing monopoly capitalism as the norm. He made no acknowledgment of Veblen's influence and perhaps there was none. Polanyi's attack on mainstream economics is of course better known today, but his timing was terrible because the United States revived the world liberal economy under its own leadership after the war; and he settled for the role of academic prophet. Veblen's vivid exposure of the contradictions of the Gilded Age did not carry with it any specific political recommendations and he too ended up as a marginal figure. Even so, these writers offer a benchmark for evaluating the "new institutional economics," whose novelty undoubtedly lies in its accommodation to ruling institutions.

NIE

The committee of the Bank of Sweden that awarded the prize cited Elinor Ostrom for "having demonstrated how common property can be successfully managed by user associations … [She] has challenged the conventional wisdom that common property is poorly managed and should be either regulated by central authorities or privatized." They further argued that users organized for the sake of managing common goods or interests often produce much better outcomes than predicted by conventional economic theory. Ostrom showed that local communities are perfectly capable of solving the "collective action problem" when governments give them a chance to do so. In this way, she refuted arguments such as Hardin's "tragedy of the commons," which claim that only private property could ensure effective conservation of re-

sources. In her 1965 dissertation, Ostrom defined a public entrepreneur as someone who "has to envision the possibilities of joint action and bring together the necessary factors of production into one unit." This too is now seen as having been prescient, with her work often being cited in the burgeoning literature on social enterprise.

If we ask why she was included on the Nobel ticket with Williamson and NIE, it is probably as a "community" counter-weight to Williamson's focus on the firm in recognition of the shifting boundary between private and public spheres. She is unusual on at least three counts: for her focus on common property and collective action, for not being an economist, and as a woman. Conversely, Oliver Williamson deserves to be acknowledged as a prime architect of institutional economics' assimilation into the neoclassical paradigm. He coined the term "new institutional economics" in 1975. By focusing on transaction costs, he sharpened debates about the shifting boundary between public and private sectors in the 1980s and 1990s, showing how market and non-market decisions, management, and service provision were similar and different. He claimed that business firms served as structures for conflict resolution, arguing that hierarchical organizations, such as companies, represent alternative governance structures, which differ in their approaches to resolving conflicts of interest.

The high theoretical rigor that Williamson brought to supporting the corporations' drive toward self-government drew heavily on his teacher Ronald Coase's theory of the firm (for which he too was awarded a Nobel Prize). The Coase theorem establishes that differential transaction costs accounted for the variable ability of firms to internalize conflicts and "externalities." Comparative analysis was therefore necessary when designing economic or for that matter legal institutions. Institutions, following Douglass North, are taken to be the "rules of the game," which is both the formal legal rules and the informal social norms that govern individual behavior and structure social interactions (institutional frameworks). In a widely cited study, Harold Demsetz (1967) drew on ethnographic and ethno-historical data to argue that the emergence of private property rights could be explained as the internalization of externalities by individual choice-making actors who were keenly aware of relative costs and benefits. Whereas the old institutional economists rejected the neoclassical paradigm, NIE works within it, albeit with some modifications.

After the "formalist-substantivist debate" petered out at the end of the 1960s, economic anthropology became a more fragmented and marginal exercise than when it was driven by Polanyi's stimulus. Some anthropologists, such as Jean Ensminger and James Acheson, did eventually coalesce under the banner of NIE. Despite the obvious links to the neoclassical paradigm, they did not necessarily see themselves as latter-day formalists, but they were committed to "hard science" using predictive models of economic behavior. In her influential study of pastoralists in Northern Kenya, Ensminger (1996) sought to demonstrate through her ethnography how markets improved local lives within a few decades. New institutions emerged to reduce uncertainty and actors' *transaction costs.* Considerable benefits accrued to individuals as a result of the breakdown of collective land tenure. Janet Tai Landa (1994) rewrote Malinowski to show that the Trobrianders' ceremonial exchanges facilitate utilitarian trade that would otherwise be too risky to pursue in an environment that lacks central political and legal institutions. She identifies a second order of rationality at the institutional level that enables individual islanders to exercise their freedom of choice, participating in *kula* expeditions as long as the benefits exceed the costs. And they say Malinowski's functionalism was reductionist!

Williamson and NIE proper are doing important theoretical work to rationalize the shifting institutional framework brought about by neoliberal policies. Despite failing to meet Veblen's criterion of an evolutionary science, they clearly are responding to the ongoing evolution of capitalist institutions. Beyond offering an ethnographic fig leaf for neoclassical economics' pretension to universality, their anthropo-

logical followers easily descend to the level of crude propaganda. Veblen and Polanyi saw markets critically as institutions, as one type among several; the "new institutional economics" treats all institutions uncritically as markets.

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Note

1. I borrowed these labels for my own analysis of the two sides of the coin as symbolic of the state/market pair in Hart (1986).

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