

## ECONOMICS AND SYSTEMS: THE INSTITUTIONALIST APPROACH

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"The purpose of studying economics is not to acquire a set of ready-made answers to economic questions, but to learn how to avoid being deceived by economists".

Joan Robinson

### 1. Introduction

The institutionalist approach (Heilbroner 1970a p. 10) deals with the emergence of new ideas of social control as a counterbalance to traditional economic liberalism, i.e., the doctrine advocating a free-competition market economy with its principle of non-intervention of the state in the "spontaneous" course of economic development. The institutionalists seek for a theory of manageable development embodied in social reform notions. As the methodological basis and prevailing theoretical notions of neoclassicism and keynesianism were revised and fell to the ground (Gruchy 1974), there emerged a tendency to the sociologization of economic thinking. The members of this movement accentuated the role of social, political, socio-psychological, and ideological factors in the economic processes and in the evolution of the social system as a whole. They seek for a new methodological approach to economic analysis, and the recognition of the need to formulate a conception of social development that could provide a theoretical basis for state policy.

### 2. Methodology of institutionalism

Institutionalism in political economy was first brought to the fore by Thorstein Veblen (1899, 1921). Among the most prominent of its members, the following are worth mentioning: J. Commons, W. Mitchell, J. M. Clark, G. Means, G. Colm, J. K. Galbraith, R. L. Heilbroner, and G. Myrdal.

This movement can be characterized by (a) its criticism of the orthodox neoclassical economic theory, and (b) its socio-political and methodological principles.

The institutionalists criticize the neoclassical conception of a competitive economy and its idea of a market equilibrium in the economic system by pointing out its narrow methodology, which ignored the role of social, political, and socio-psychological factors in the economic mechanism. They study the market as a social institution, as a social system, which is transformed in the course of the economic evolution together with the whole institutional system. Thus, for instance, the institution-

alists maintained that the damage done to the environment and the social costs of private enterprises are not reflected in market evolution (Clark 1926, 1936). Further, market mechanism takes into account the satisfaction only of those social requirements which are represented by effective demand, while requirements in education, health care, and other social benefits should be satisfied at the expense of taxes. Meanwhile, however, socio-cultural services tend to acquire increasing importance for economic progress and social well-being in the broad sense of the word.

According to some neoinstitutionalists, the deformation of the market mechanism is due to the private monopoly regulations of prices and production, to the relationships among large corporations, small and medium-scale enterprises, the government, and the labor unions (Galbraith 1973-75). In highly developed economies, where giant corporations play the decisive role in production and where there have been considerable changes in the levels and structure of mass consumption, market instruments of economic regulation are bound to play a lesser role (Galbraith 1967-78). At this stage of economic development, the behavior of economic subjects (producers and consumers) can no longer be determined solely by market incentives. Extra-market and extra-economic factors and considerations come to play an ever more important role in economic processes (Heilbroner 1965, 1970a).

Taking into account the above considerations, the institutionalists seek to study the interplay of economic and non-economic factors in socio-economic development: the structural, organizational, and functional aspects of the economic mechanism as a system, regarding the economic sphere as part of an integral social organism interacting with other subsystems. (See Braudel 1982 Ch. 5 on society as a set of systems). Economic theory here comes into close contact with other social disciplines (sociology, political science, social psychology, anthropology, history) in order to overcome their self-sufficiency and isolation from each other. As Leontief (1977 p. 29) points out, "To deepen the foundation of our analytical system it will be necessary to reach unhesitatingly beyond the limits of the domain of economic phenomena as it has been staked out up to now. The pursuit of a more fundamental understanding of the process of production inevitably leads into the area of engineering sciences. To penetrate below the skin-thin of conventional consumption functions, it will be necessary to develop a systematic study of the structural characteristics and of the functioning of households, an area in which description and analysis of social, anthropological, and demographic factors must

obviously occupy the center of the stage". I.e., Leontief is asking for a systemic approach to economics "that would involve crossing the conventional lines separating ours from the adjoining fields" (Leontief 1977 p. 29).

In this line of thought, "institutions" (i.e., systems) are the main object of research: their origins, evolution and role in determining the economic behavior of individuals and social groups. The institutionalists deal, therefore, with an inter- and multidisciplinary approach to economic analysis. Accordingly, a theory that helps understanding (and governing) socio-economic processes should be developed within a framework of "political economy" (Galbraith and Salinger 1979). Such a theory should assimilate the valuable ingredients of all other doctrines (Lowe 1965, Heilbroner 1970b) (1). Further, neoinstitutionalists advocate a normative approach where evaluations have to be scientifically validated. What is needed today, they say, is a new universally accepted system of social and ethical values to meet the new conditions and society requirements at the present stage of social development. Thus, new codes of behavior should be developed for various social groups in order to reach a minimum consensus to the solution of imperative social problems (Leontief 1982a).

### 3. Present-day institutionalists

While from a Marxist point of view the nature and limitations of adaptational institutional changes are determined by economic conditions, for some institutionalists they are due to science and technology lying at the root of production, what Galbraith has called 'technostructure' (2).

According to Galbraith (1967-78, 1973-75), the 'technostructure' is the vehicle of large corporations, which control supply and demand, provision of capital and minimization of risk in the so-called "planning economy". Galbraith contrasts the power of the large, huge corporations -which manifests itself in corporate planning- with the power of the market. According to him (Galbraith 1973-75) there are two types of contradictions in all modern industrialized societies:

- (i) those between the interest of the "planning system" and society; and
- (ii) those between the "planning" and the "market" systems.

The main contradiction in modern societies is not between classes, but between the two economic systems: the "planning system" related to big corporations, and the

"market system" related to small enterprises. This, at the world level, is the contradiction between the North (industrially developed) and the South (underdeveloped) (Galbraith 1983). The result is clear: "The will to national independence is the most powerful force in our time" (Galbraith 1983 p. 36). The new countries, "reject domination by either of the great powers and ask only for the same right of self-determination desired by all nations, old and new" (Galbraith 1983 p. 45) (3).

According to Galbraith (1973-75 p. 173), "The planning system [i.e., the corporation-dominated part of the economy], in the absence of state intervention, is inherently inestable" (4). The old financial oligarchy, blamed by Lenin and present-day Soviet economists, has given room to the 'technostructure' both in the West and in the East with economic and political power over the "market". In fact, large corporations have similar imperatives whether in the West or in the East: the same organizational structure and communal need for planning respond to the same technological needs. "The decisive power in modern industrial societies is exercised not by capital [Lenin and modern Soviet economists] but by the industrial bureaucrat. This is true in the Western planning systems. It is also true in the socialist countries" (Galbraith and Salinger 1979 p. XIV). The possession of capital is now no guarantee that the required 'technostructure' can be organized. Since technology and planning are what accord power to the technostructure (Galbraith 1967-78), the latter will have power wherever these are a feature of the productive process within either the capitalist or the socialist system. (Caveat: "Decentralization in the Soviet-type economics involves not a return to the market system but a shift from planning functions from the state to the firm. (...) There is no tendency for the Soviet and the Western systems to converge by the return of the former to the market. Both have outgrown that. There is measurable convergence to the same form of planning" (Galbraith 1967-78 p. 100).

#### 4.- The planning of the planning system

Some neoinstitutionalists believe that there cannot be a satisfactory control of business until the government is freed from the powerful influences of those who manage the large corporations (Gruchy 1974). Different solutions have been proposed for this control:

(a) the "domestication" of private business by establishing a national planning program, or what Clark (1926) described as 'social-liberal planning' (5):

(b) the planning of the planning system (Galbraith 1973-75) by a planning authority. Galbraith describes this

sort of planning economy of the future as a "new socialism", a non-Marxian type of socialism (6). (According to Heilbroner (1974 pp. 57-58 & 84), if economic development is to be directed in the interest of society there will have to be a "full-fledged transformation of 'private' capitalism into 'planned' state capitalism").

In the view of present-day neoinstitutionalists, there is today a need for both national and international planning, for as Gruchy (1974 p. 246) puts it, "national planning cannot work well in the long run without considerable international planning". The problems of energy shortages and transnational corporations' activities cannot be tackled successfully as purely domestic problems. This social control of business is one of the gravest issues of our times, claim the neoinstitutionalists.

The social control over the economy in present-day society needs to set up and develop a state system of indicative planning (Galbraith 1973-75, Leontief 1977 Ch. 11). Planning is one of the instruments of state power and should be used to enhance social justice (see below, Section 4.1). State planning implies social compromise, social cooperation and consensus (6). This way, planning can avoid the overexploitation of economic resources and reduce the negative side-effects in the natural and social environment of private and public enterprises. Moreover, the economic growth should be assessed on the basis of a broad complex of criteria reflecting indicators of quality of life instead of the merely Gross National Product.

#### 4.1. Planning and economics

Two main arguments have been advanced in favor of planning by Leontief and Galbraith (Leontief and Stein 1976). The first is the need to coordinate the existing forms of government regulations through an independent agency that will provide "information to legislators and administrators responsible for national economic policies (...) outlining appropriate methods to carry them out" (Leontief 1982a p. 33) (7). The second is that the 1970s ushered in a new stage in the development of the economy, when government regulation had to concentrate its efforts not so much in managing demand as on solving the problem of supply over the long term. Indeed, the 1970s showed that, in contrast to the preceding period, the problem of increasing scarcity of resources was coming to the fore: I.e., the supply of resources which could not be increased on the basis of purely market incentives or through stimulation of aggregate demand by the government—meaning the industries turning out basic resources (like energy, raw materials, and foodstuff), sections of the infrastructure (like transportation and communications), and

finally the rehabilitation, and protection of the environment (8). The need to solve such problems connected with production and supply calls for long-term programming of the national economy, even for international programming, for, the interdependence of the different sectors of a national economy needs their coordination (9) not only at the national level but also international. (See Leontief 1966 Ch. 7 & 11, 1977 Ch. 11 for a general approach to national economic planning, its methods and problems). Many projects started today, the so-called industrial reconversion among others, will depend, for their ultimate success, on whether they are coordinated with other projects of development taking place not only in a given national economy but in other parts of the world (10).

The kind of planning espoused by the neoinstitutionalists emphasizes, above all, the information importance of the plan. According to Leontief (1977 Ch. 11), the plan should describe the development of the economy as a whole, including its key sectors (industry, agriculture and transport), and also the federal and local budgets for 4-5 years ahead. Leontief asks for several alternative scenarios to allow a choice of possible ways to attain a given set of goals. This analysis of the economic structure can, indeed, "provide a suitable framework for a concret (...) description of alternative methods of production and the realistic realization of alternative paths of technological change" (Leontief 1977 p. 152), for it is essential to analyze the potential effects on the economy and society of new technologies. (See Leontief and Duchin (1985) for the effects of the implementation of microelectronics on the economy and society; Leontief (1966 Ch. 9 & 10) for the economic effects of disarmament; Leontief and Duchin (1983) for the effects of military spending on civilian technology; and Leontief (1985) for the choice of technology). This way, different scenarios can be worked out for different economic and social policies that could permit the country to reap the benefits of the new technologies while mitigating their disruptive effects.

The choice between alternative scenarios is the key to rational planning. Such scenarios should be worked out not only on the national but also on the regional and local levels and should be duly dovetailed with each other. (According to Leontief (1977 Ch. 11 & 1982a) an autonomous government agency should be set up to work out these scenarios (7)).

The policy of national economic planning should have the following goals:

(a) agreement between lines of economic policy from the standpoint of attainable strategic goals;

(b) reliable economic information of the effects of individual events or government intervention in the economy as a whole; and

(c) the arrangement of research to bring out the problems that could arise in the future.

#### 5. Upshot

The free market, so praised by neoclassicists, is gone as Galbraith has repeatedly showed. (See also Eichner (1983), Leontief (1982b, 1983), and Thurow (1983) for the state of economics and more criticism to neoclassical and keynesian policies). Modern economy is a mixture of two systems: the planning one with big corporations, large farmhouses, big labor unions and the government; and the market one with small enterprises, farmers, and consumers. It is the large corporations that set the price. Governmental regulations are the only protection for small business and the public. Central planning is used not only by big corporations but also to regulate socialist economies and should also be used to guide the economic growth of Third World countries. In the later case, the state must play the leading economic role, for it is the only social institution with the financial resources and the political power needed to do so.

Today the dilemma is not freedom versus planning, but that between democratic and authoritarian planning: between participative and decentralized planning on the one hand, and bureaucratic and rigid planning on the other. The choice between an alienating planning and a genuine one is not a technical choice to be made by experts but a political and social choice to be made by the public (Leontief 1977).

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## NOTES

(1) According to Lowe (1965), political economy should enable to formulate goals and to choose the methods and instruments for influencing the behavior of economic subjects so as to ensure the efficient functioning of the entire economy.

(2) For Leontief (1977 p. 19), "Most of the common interest groups, mergers, and trusts typically of today's economic development have come into existence because of a striving for a technological, not an economic optimum. Of course, economic consolidation is factor, but it would be (...) wrong to consider this economic factor (...) decisive with regard to concentration (...) in our view the concentration problem, on the whole, is basically a technological problem".

(3) "The error (...) is (...) common to both the advanced capitalist and socialist countries. Both have taken what is appropriate to their own late stage of development and applied it, automatically, to the new nations, which are in the earlier stages" (Galbraith 1983 p. 9), for "The economic design appropriate to the later stages of development cannot, without waste and damage, be transferred to the earlier stages. Nor as regards the new countries can the design and emphasis appropriate to a country in one stage of the political, cultural, and economic sequence be applied in a later or earlier stage" (*op. cit.* p. 8). Further, according to Leontief et al. (1977 p. 10-11), in developing countries, "The principal limits to sustained economic growth and accelerated development are political, social and institutional in character rather than physical. No insurmountable barriers exist within the twentieth century to the accelerated development of the developing countries".

(4) The problem of the state is the main difficulty, for the big corporation is closely tied in with the state. For Galbraith (1973-75), today the main stake is on reform. The state also should be an object of reform. This idea of gradual reform is one of the main features of the institutionalist theory of social development.

(5) According to this view, large corporations should be placed in an institutional framework in which all sectorial interests, including private business, would be subordinated to the national interest. "This control could not be effective in an unplanned capitalist system dominated by private business interests with the power to undermine regulatory agencies and to substitute private business welfare for national interest" (Gruchy 1974 p. 242).

(6) As Myrdal points out (quoted in Gruchy 1974 p. 243), any experiment in the control of private enterprises with the aid of national planning would call for a public support from a combination of workers, low-income farmers and beleaguered consumers. "What is needed is a general agreement between organized labor and organized business that would apply to major sectors of the economy and would be based on a carefully designed, comprehensive and voluntary plan" (Leontief 1982a p. 34).



(7) According to Leontief (1982a p. 33), this independent agency should provide the "information needed to work out a systematic, coordinated approach to the main problems of national and local economic policy. (...) it should be able to anticipate potential trouble spots, the parts of the economy where, to name only a few examples, energy shortages, technological unemployment, population movements, or sudden needs for long-term credits may arise. This agency should not make grand predictions but should elaborate different scenarios, each describing likely effects to any particular combination of national, regional, and local economic policies. This would, in fact, be the only means by which the government and the electorate would be able to make informed choices among different policies". For Galbraith (1973-75 p. 307), "The state, in short, will take to effects the coordination of which the planning system [the part of the economy dominated by big corporations] is incapable. There will have to be a public planning authority. This, in turn, will have to be under the closest legislative supervision". This planning of the planning system should reflect not the corporation's goals but the public purpose (Galbraith 1973-75 p. 307). A second major problem is the coordination of planning policies as between the national planning systems, for "National planning systems, operating internationally, also require a measure of international planning" (Galbraith 1973-75 p. 311).

(8) See Leontief (1977 Ch 6 & 7) for the study of the environmental repercussions of pollution on the economic structure within an input-output approach. (For input-output analysis see Bulmer-Thomas (1982) and Miller and Blair (1985)).

(9) "Under a planning approach national economic policies are not formulated as independent measures designed to solve particular problems, whether it concerns environmental degradation, energy shortage, inflation, unemployment, or urban blight. They are coordinated actions intended to make the entire economy function more effectively and grow along a carefully projected plan" (Leontief 1982a p. 31).

(10) The interdependence of the different parts of the economy and alternative paths along which they might advance in the coming years must systematically explored. "Whether one path or another is followed is not a professional question but a political decision that must be reached by democratic processes" (Leontief 1982a p. 31). Further, "it is not surprising that actions to solve a particular problem create new problems elsewhere. If policy makers act in ignorance of such indirect interrelationships, measures taken by one government or corporate office will tend to cancel out the effects of actions taken by another" (Leontief 1982a p. 32). Therefore, the need of planning at different levels.

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### Resumen

Se expone en este trabajo lo que caracteriza el enfoque institucionalista de las doctrinas del liberalismo económico tradicional. Desde la perspectiva de los primeros, se considera el mercado como un sistema social que se transforma junto con el total del sistema de las instituciones. Por ello, tratan de estudiar las interrelaciones entre los factores económicos y no económicos del desarrollo.

Entre los institucionalistas, se toma la planificación como una forma de control social de la economía, como un instrumento de la justicia social -en un planteamiento fundamentalmente informativo que debería proporcionar varios escenarios alternativos para alcanzar un conjunto preestablecido de objetivos-.

Si tenemos en cuenta que la economía moderna es una mezcla de dos sistemas: el de planificación, a cargo de las grandes compañías y el gobierno, y el de mercado, a cargo de consumidores y pequeñas empresas, y si además contamos con que los precios los marcan las primeras, la única defensa para consumidores y pequeños empresarios está en las regulaciones que imponen los gobiernos. Así, el verdadero dilema de hoy en día no sería la alternativa planificación-no planificación, sino el establecimiento de una planificación democrática o, por el contrario, de una autoritaria. Se trata, ésta, de una elección político-social que ha de ser hecha por el público y no por un grupo de expertos.