**CHAPTER TWO**

**Heterodox Economic Thought**

**2.1. Early Critics of Neoclassical Economics (refer chapter one)**

The early critics of neoclassical economics had little in common other than an objection to orthodoxy. This objection was manifested in various ways by various writers, but in general it was a dissent from the scope, method, and content of orthodox theory, as well as a rejection of the orthodox economists’ view that harmony prevails in a market economy and that laissez faire is therefore the proper governmental policy. Thus, the heterodox dissent is a scientific as well as an ethical dissent. Many heterodox writers explicitly charged orthodox theory with containing normative or ethical judgments that it attempted to hide by pretending to develop a positive science.

Veblen, who preached the scientific method but practiced impressionistic writing, taught Mitchell, who practiced science but was reluctant to reach any theoretical conclusions from the data he collected. Neither writer offered a theoretical structure to replace the model he was criticizing. Commons did offer an alternative structure, but it was not seriously considered by subsequent economists—either orthodox or heterodox. Institutionalist and other heterodox criticisms of neoclassical economics did not end with the early critics. As the institutional structure of Western economies changed, neoclassical theory, based on an institutional structure most relevant to a pure market economy, did not change; instead, it simply retreated deeper into pure abstract theory with little or no direct policy relevance. Heterodox economic thought that challenges mainstream thinking that are institutionalist in that they are the intellectual heirs of Veblen, Commons, and Mitchell are focusing more and more on the separation of orthodox theory from reality

**2.1.1The Historical School**

Heterodox economists have little in common besides an objection to orthodoxy. While manifesting their objections in differing ways, they constitute a dissent from the scope, method, and content of orthodox theory. Radicals, institutionalists, and post-Keynesians reject the orthodox view that harmony prevails in a market economy and that laissez faire is therefore a proper governmental policy. Public choice advocates and neo-Austrians, who tend to be to the political right of mainstream economics, are uneasy with the degree of governmental intervention in markets that orthodox theory finds acceptable. One way to understand the issues separating orthodox and heterodox writers is by examining the questions they were trying to answer. Whereas, modern orthodox theorists have largely focused on the four problems of allocation, distribution, stability, and growth. heterodox economists have studied the forces that produce changes in the society and economy. Whereas orthodox writers have taken as given (something they are not interested in explaining) the specific social, political, and economic institutions and have studied economic behavior in the context of these institutions, heterodox writers have focused on the forces leading to the development of these institutions. Often what orthodox writers take as given, heterodox writers try to explain; and what heterodox writers take as given, orthodox economists try to explain. Thus, the differences between heterodox and orthodox economists are often differences in focus, not diametrically opposed theories.

* The neoclassical period ended, in part, because the flaws in neoclassical economics had been pointed out by dissenting, or heterodox, economists. Neoclassical economics responded to those complaints in three ways: (1) it ignored the criticisms as unfounded; (2) it incorporated all or part of the criticism into the scope, content, and method of the dominant theory; and (3) it developed a way to get around the problematic issues. The term “neoclassical economics” was coined by Thorstein Veblen to provide a target upon which to make his dissent. Mainstream economists of Veblen’s time did not call themselves neoclassical; heterodox economists called them this, and the term quickly became a negative caricature of the beliefs of the mainstream economists, rather than a characterization of what they actually believed.
* Thus, the more important and interesting proponents of heterodox economic theory, past and present, appear along with the major orthodox thinkers. . **Modern heterodox thinkers fall roughly into five dissident groups: radicals, modern institutionalists, post-Keynesians, public choice advocates, and neo- Austrians. Each of these shares some history with the mainstream(Neoclassical) but differs in its perception of which previous economists deserve to be remembered and which forgotten.**

**Interesting contrasts and comparisons among the heterodox groups:**

* First, even though they often disagree among themselves about the shortcomings of mainstream economics, they nearly always concur on the necessity of extending the scope of mainstream analysis. For example, even though public choice theorists and radicals fall on opposite sides of the political spectrum, they agree that politics and economics cannot be separated. Second, even though heterodox economists are often ignored by the mainstream, they nonetheless influence it. As they do, and as their ideas are sometimes incorporated into the mainstream, their role as heterodox economists is reduced. Thus, longevity is not necessarily a positive attribute of heterodox thought. Third, heterodox economists have a tendency to turn inward and separate themselves from the profession—in which case their analysis becomes a separate field of study that either totally replaces mainstream economics or continues its existence independently of the mainstream. Fourth, nearly all heterodox schools are partisan; and for a group to have a significant impact on theory.

**Table 1: Heterodox Economics**

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|  |  | **Radicals** | **Institutionalists** |
| **1.** | **Views on individual rationality** | Individuals follow class beliefs; self-expression is extremely difficult in a capitalistic society. | . Individualist psychology is incorrect; people learn tastes through culture |
| **2.** | **Policy view** | Government reflects ruling class; major changes in form of government are necessary for serious reform. | Favor more government intervention. |
| **3.** | **Theory of production** | Some hold labor theory of value; some reject labor theory of value. Tend to believe that capitalists extract surplus from workers. | Firms use rule of thumb to determine prices; focus on institutional constraints on pricing. |
| **4.** | **Theory of distribution** | Class theory of distribution based on power of ruling groups. | Distribution determined by institutions and legal structure; market is less important. |
| **5.** | **Some leading living advocates** | Anwar Shaikh, Samuel Bowles, Herbert Cintis. | John Adams, Warren Samuels. |
| **6.** | **Macroeconomic views** | Economy tends toward crisis and unemployment without massive state intervention. | Oppose models based on global rationality; relevant models must have more institutional structure; generally support Keynesian policies. |

**Table 2: Heterodox Economics**

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| --- | --- | --- |
| **Post-Keynesians** | **Public Choice Advocates** | **Neo-Austrians** |
| Uncertainty makes individual rationality difficult. | Individuals are rational in all aspects of life, including politics; rent-seeking is important. | Radical individualism; close association with libertarian philosophy. |
| Tend to favor government intervention. | Government is a reflection of individuals’ political interest. The less government involvement, the better. Strongly oppose government intervention as a form of rent-seeking. | Strongly opposed government intervention on moral grounds; it violates individuals’ rights. |
| Firms use cost-plus pricing; margin determined by need for reinvestment. | Profit maximization on individual level. Generally accept mainstream views, although rent-seeking can lead to monopolization. | Profit-maximizing firms. |
| Macroeconomic distribution theory determined by profit- wage mix. | Marginal productivity theory of distribution modified by rentseeking. | Marginal productivity theory; focus on property rights. |
| Oppose IS-LM. Uncertainty makes modeling difficult. Believe in multiple equilibria. | Take an essentially micro- economic view; a separate macroeconomics does not exist. | The market process is important; mainstream models lose the required focus on markets. |

## MAJOR TENETS OF THE INSTITUTIONALIST SCHOOL

* **Holistic, broad perspective**. The economy must be examined as a whole, rather than examined as small parts or separate entities isolated from tile whole. A com­plex organism cannot be understood if each segment is treated as if it were unre­lated to the larger entity. Economic activity is not merely the sum of the activities of persons motivated individually and mechanically by the desire for maximum monetary gain. In economic activity there are also patterns of collective action that are greater than the sum of the parts. A union, for example, develops a char­acter, an ideology, and a method of operation of its own. Its features cannot be deduced from the study of the individual members who belong to it.

Even the concept of economic activity is too narrow in the institutional­ists’ view. Economics, they assert, is intertwined with politics, sociology, law, custom, ideology, tradition, and other areas of human belief and experience. Institutional economics deals with social processes, social relationships, and society in all its facets.

* **Focus on institutions.** This school emphasized the role of institutions in eco­nomic life. An institution is not merely an organization or establishment for the promotion of a particular objective, like a school, a prison, a union, or a federal reserve bank. It is also an organized pattern of group behavior, well-established and accepted as a fundamental part of the culture. It includes customs, social habits, laws, modes of thinking, and ways of living. For instance, slavery and a belief in slav­ery were institutions. Other examples are the beliefs in laissez-faire, or union­ism, or a government social security system. Going out on new year's eve to raise a din and clatter is an institution. So was communist ideology in the Soviet Union and anticommunism in the United States. Economic life, said the institutionalists, is regulated by economic institutions, not by economic laws. Group social behavior and the thought patterns that influence it are more germane/relevant to economic analysis than is the individualism emphasized in marginalist theory. The institutionalists were especially interested in analyzing and reforming the institutions of credit, monopoly, absentee ownership, labor-management rela­tions, social security, and the distribution of income. They advocated economic planning and the mitigation of the swings of the business cycle.
* **Darwinian, evolutionary approach.** The evolutionary approach should be used in economic analysis, because society and its institutions are constantly changing. The institutionalists disagreed with the static viewpoint that sought to discover eternal economic truths without regard for differences of time and place, without concern for changes that were occurring constantly. Instead of asking "What is?" the institutionalists asked "How did we get here, and where are we going?" The evolution and functioning of economic institutions should be the central theme in economics. This approach requires knowledge not only of economics but also of history, cultural anthropology, political science, sociol­ogy, philosophy, and psychology.
* **Rejection of the idea of normal equilibrium.** Rather than the idea of equilibrium, institutionalists emphasized the principle of circular causation, or cumulative changes that may be either salutary or harmful in seeking economic and social goals. Maladjustments in economic life are not departures from normal equilib­rium but rather are themselves normal. Before World War II the outstanding maladjustment was the business slump. Then, the problems of economic devel­opment became the center of attention. In the late 1970s the problem became stagflation, the simultaneous occurrence of inflation and unemployment, whereas in the mid-1980s, problems of trade deficits and federal budget deficits arose. The institutionalists are convinced that collective controls through gov­ernment are necessary to continually correct and overcome deficiencies and mal­adjustments in economic life.
* **Clashes of interest.** Instead of the harmony of interests that most of their con­temporaries and predecessors deduced from their theories, the institutionalists recognized serious differences of interests. People, said the institurionalists, are cooperative, collective creatures. They organize themselves into groups for the members mutual self-interest, which becomes the common interest of the group. There are, however, clashes of interests between groups, such as big busi­ness against small business, consumers against producers, farmers against urban dwellers, employers against workers, importers against domestic producers, and the makers of goods against the lenders of money. Here, again, a representative and impartial government must reconcile or override clashing interests for the common good and for the efficient working of the economic system.
* **Liberal, democratic reform.** The institutionalists espoused reforms in order to bring about the more equitable distribution of wealth and income. They denied that market prices are adequate indices of individual and social welfare and that unregulated markets lead to the efficient allocation of resources and a just dis­tribution of income. The institutionalists invariably condemned laissez-faire and favored a larger role for government in economic and social affairs.
* **Rejection of pleasure-pain psychology.** The institutionalists repudiated the Benthamite underpinnings of economic analysis. They reached out instead for a better psychology, and some of them incorporated Freudian and behaviorist ideas into their thinking.

**2.1.2 The Old (Traditional) Institutional School**

An institution is defined as collective action in control, liberation and expansion of individual action. Its forms are unorganized custom and organized going concerns. The individual action is participation in bargaining, managing and rationing transactions, which are the ultimate units of economic activity. The control by custom or concerns consists in working rules which govern more or less what the individual can, must, or may do or not do.

* Institutionalists forcefully argue that interactions between economic, cultural, and sociological issues are too great to warrant the isolated focus on economic forces that constitutes the thrust of much modern economic thought.
* Institutionalist theory has had several important coordinates, including: (1) a theory of social change, including an activist orientation toward social institutions; (2) a theory of social control, with a focus on the importance of collective action through the legal–economic nexus; (3) the importance of technology and, thereby, of industrialization; (4) the market seen as functioning within and giving effect to institutions, including the fundamental theme that it is not markets which allocate resources but the institutional and organizational structure of the system; (5) a theory of value centering, not on the exchange ratios between commodities, but on the values ensconced within the working rules of law and of morals which structured, governed access to, and governed the performance of markets and other domains of economic activity, such as government. In other words, Institutionalism, far from seeking unique determinate optimal equilibrium solutions, sought to identify the factors and forces operative in the process of working out solutions to problems; and far from postulating a pure conceptual abstract a-institutional economic system, sought to deal with institutionally driven economies and the processes through which those institutions were formed, changed and operated. In both of these respects and also in regard to the foregoing coordinates, institutionalism has been, by comparison with mainstream neoclassical economics, holistic, and empirical.

**Institutionalists divided into three sections: (1) Traditional(Old) Institutionalist economists in the tradition of Veblen, Mitchell, and Commons; (2) what we call the Quasi-Institutionalists— writers whose ideas resemble those of the institutionalists but who are too iconoclastic to fit the traditional institutionalist mold; and (3) neoinstitutionalists—economists who write in a neoclassical choice-theoretic tradition but who believe that institutions must be far better integrated into current practice than is currently done, both in theory and in practical applications of theory.**

* Veblen, Common and Mitchell formed the Older institutional school, while a host of writers of the younger generation, namely W.E Atkins, Tyson, S.H Slitcher, W.H Hamilton, A.B Wolfe, R.G Tugwell, etc. comprise the younger school. The older school is chiefly concerned with the description of economic life institutions and instincts pointing out the maladjustments which they may found. They do not set any goals and would like the social evolution to take its own course. Their approach is essentially critical and negative. On the other hand, the approach of the younger school is positive. Their chief objective is to direct social evolution in such a way that social institutions and human activities may move simultaneously. They also seek to replace old economics with new economics. They carried out important researches in the field of sociology, history, and statistics; and succeeded in arousing a permanent interest in social reform.

**THORSTEIN BUNDE VEBLEN(1857-1929)**

**His Biography:**

Thorstein Bunde Veblen, the son of Norwegian immigrants was born on a frontier farm in Wisconsin and raised in rural Minnesota. He completed his undergraduate college education at Carleton College, Minnesota, where he was a student of J. B. Clark. His graduate work was done at Johns Hopkins, where he failed to obtain a scholarship, and at Yale, where he received a doctorate in philos¬ophy. No academic position was available to him, however, largely because he held agnostic views at a time when a divinity degree was considered a desirable prerequisite for teaching philosophy.

Veblen received fellowships at Cornell and at the University of Chicago for postdoctoral work. He became the editor of the Journal of Political Economy at Chicago. Veblen never reached the rank of full professor, despite his eleven books and his lasting world reputation. In 1918 he worked briefly for the Food Administration in Washington, D.C., and served as an editor of the journal The Dial. A former student aided him financially in his later years. He died in August 1929, a few months before the great stock market crash and the beginning of the depression he had been predicting. Veblen was a bitter, skeptical, pessimistic, and lonely man. His books, though written somewhat ponderously and obscurely, are replete with wit, wisdom, and sardonic attacks on middle-class virtues.

**The main contributions of Veblen to economic thought.**

**1)His theory of the Leisure Class**

Veblen's first and most popular book was The Theory of the Leisure Class, published in 1899. The leisure class is characterized by conspicuous consumption, a propensity to avoid useful work, and conservatism. Conspicuous consumption. Veblen held that the leisure class is engaged in the predatory seizure of goods without working for them. Those who accumulate wealth do so not merely to take care of their physical wants, or even their spiritual esthetic, and intellectual wants. Rather, they wish to consume in a way that displays their wealth, because a show of wealth indicates power, prestige, honor and success in our pecuniary (monetary) culture. To be reputable, such consumption must be wasteful. Poorer people must work in order to subsist, but even their pattern of spending includes an clement of wasteful conspicuous consumption. Their outlook on life is imposed by the dominant leisure class.

Propensity to avoid useful work. Members of the leisure class must avoid useful, productive work. They must indulge only in wasteful or useless tasks if they are to remain reputable. Force and fraud arc present today, Veblen said, as they were among barbarian peoples. We find them in modern warfare, in business, and in sports and games: Conservatism. Veblen asserted that the evolution of social structure has been a process of natural selection of institutions. Progress can be attributed to the survival of the fittest habits of thought and the enforced adaptation of individuals to a changing environment. Institutions must change with changing circumstances. The development of these institutions represents the development of society. Unfortunately there is a conflict between current beliefs (ceremonial institutions) and current requirements (dynamic technological institutions) because of the cultural lag in the process of change:

A portion or class of society that is sheltered from environmental forces will adapt its views more slowly to the altered general situation and will, therefore, retard the process of social change. The wealthy leisure class is in just such a sheltered position with respect to economic forces that make for change or readjustment. The characteristic attitude of this class is indicated in the maxim that, "Whatever is, is right." But the law of natural selection, as applied to human institutions, asserts that, "Whatever is, is wrong." That is, current institutions are wrong to some extent, from the evolutionary standpoint, because they do not change quickly enough to be in tune with the times.

**2)His Attacks on Neoclassical Economics**

Veblen's theory of the leisure class constituted an attack on neoclassical economics, which assumed that consumers are sovereign. Through their "dollar votes" consumers determine the composition of commodities produced and therefore the allocation of society's resources that will maximize welfare. But if large portions of consumption are undertaken mainly to impress neighbors, who strive to retaliate by purchasing similar items to maintain their relative status, then government might be able to enhance overall well-being by restricting "wasteful" consumption by everyone. As pointed out by Breit and Ransom, “Thus, Veblen, in making economic man into social man, upset the [laissez-faire] policy implications of neoclassical consumption theory.”

Veblen also accused the neoclassicists of supporting the present scheme of the distribution of wealth and income. Standard theory, he thought, is not truly a theory of anything, but merely folklore or theology used to justify private property and property incomes. Business economics has been developed to defend the business community, and the questions it asks and seeks to answer are not relevant to the population as a whole. Veblen was concerned with social economics instead of the business economics of price, profit, and ownership.

Finally, it is interesting to note that Veblen attacked the notion of perfect competition, which then dominated standard economic theory. He recognized that most businessmen had some monopolistic control over the prices they charged and that they used advertising to strengthen their market positions. This analysis, published in 1904, foreshadowed the rise of the theory of monopolistic competition in 1933.

**3)His Credit and Business Cycles**

According to Veblen, credit plays a special role in modern business. Borrowing money can increase profits as long as the current rate of business earnings exceeds the rate of interest. Under competitive conditions, what is profitable for one businessperson to undertake becomes compulsory for all competitors. Those who take advantage of the opportunities afforded by credit are in a position to undersell those who do not. The recourse to credit, therefore, becomes widespread and typical. The competitive earning capacity of an enterprise comes to rest on the basis of the initial capital plus such borrowed hinds as this capital will support. The competitive use of credit in extending business operations gives an enterprise a differential advantage against other competitors, but the credit expansion has no aggregate effect on earnings or on total industrial output. In fact, aggregate net profits from industry are reduced by the amount of interest that has to be paid to creditors outside the industrial process.

Veblen's views on credit led him directly into his business-cycle theory. The extension of credit enables competing businesspeople to bid up the prices of the material capital goods used in industry. As their dollar value increases, these goods serve as collateral for the further extension of credit. The extension of loans on collateral such as shares of stock or real property has a cumulative character. Credit expands even more with the organization of monopolies, because the expected increase in the profits of monopolies and the imputed goodwill of the new corporations also are capitalized in the prices of the securities issued.

This cumulative extension of credit rests on a shaky foundation. Sooner or later a discrepancy will arise between the money value of the collateral and the capitalized value of the property computed on expected earnings. In other words, the rise in earnings will not keep pace with the rise of the nominal value of capital (capital plus loans). When this discrepancy becomes obvious, a period of liquidation begins. Along with liquidation, the industrial crisis is accompanied by credit cancellations, high discount rates, falling prices, forced sales, shrinkage of capitalization, and reduced output. The creditors take over business properties, thereby further consolidating ownership and control into fewer hands.

Workers benefit during prosperity not through higher rates of pay but through fuller employment. As the general price level rises, the increased cost of living reduces real rates of wages. Slowly money wages rise in response to increasing prices of goods, and this helps bring prosperity to an end, because profit margins shrink and capital values fall.

Veblen thought that the discrepancy between capitalization and earning capacity is chronic so long as no extraneous circumstances enter temporarily to set aside the trend of business affairs. Therefore, chronic depression, more or less pronounced, is normal under the fully developed regime of machine industry. Depressions are temporarily overcome, however, by speculative increases of prices, new discoveries of precious metals, and credit expansion. The deliberate promotion of monopoly can restore the profitability of business by restricting output and raising prices, thereby bringing the accepted capitalization in line with the actual earning capacity. If successful, the monopoly will neutralize the cheapening of goods and services affected by current industrial progress.

The decline of profits and chronic depression can be remedied by an increase in the wasteful and unproductive consumption of goods as well as through monopoly. But private wasteful expenditure on a scale adequate to offset the surplus productivity of modern industry is nearly out of the question.

**JOHN R.COMMONS (1862–1945)**

John R. Commons received his education at Oberlin College and Johns Hopkins University and spent the majority of his career as a professor at the University of Wisconsin, where he was a founder of what became known as the “Wisconsin school” of institutional economics.

* First, Commons became the first historian and theoretician of the labor movement in the United States. He envisioned labor unions as legitimate means of securing the legitimate interests of workers and both labor relations legislation and protective labor legislation as providing legal protection for labor interests in a manner paralleling the protection given to other interests under the name of private property.
* Second, Commons analyzed the evolution of the introduction – over many centuries –, organization and control of the modern economic system, exploring what he called the legal foundations of capitalism. His analysis encompassed a model of interpersonal relations specified in quasi legal terms; a behavioristic theory of psychology; theories of social control and social change; a theory of the nature, formation and roles of the working rules of law and morals; a theory of language and its role in the social construction of reality, including the sense of continuity provided by using the same term – such as freedom and property – even though its relevant substantive content changed over time; theories of system and institutional organization, especially of property, markets, government and business firms; a theory of power structure and a theory of the legal–economic nexus, including a theory of conflict resolution.
* Third, Commons was involved in a series of experiments, both directly and through his students, at both state and national levels, in which legislation was crafted and enacted to promote hitherto neglected interests. These were in the areas of public utility regulation, workmen’s compensation, civil service reform, control of working conditions and other areas of protective labor legislation, unemployment insurance, social security, and so on. Commons was also actively involved in monetary reform and antitrust enforcement.
* Fourth, Commons sought to extend his legal–economic analysis and to combine it with both his interpretation of mainstream economics and still other bodies of knowledge, with the objective of producing a general institutional-economics theory.This was his least successful activity.
  1. **.The development of Modern Heterodox school**

**“There is much of the past that is in the present, so also there is much of the present that will be in the future.”—John Kenneth Galbraith**

The neoclassical period ended, in part, because the flaws in neoclassical economics had been pointed out by dissenting, or heterodox, economists. Neoclassical economics responded to those complaints in three ways: (1) it ignored the criticisms as unfounded; (2) it incorporated all or part of the criticism into the scope, content, and method of the dominant theory; and (3) it developed a way to get around the problematic issues.

**2.2.1. The New Institutionalist(Neo- Institutionalist) School**

The “neoinstitutionalists” include more institutional detail in their theoretical models than was usual for neoclassical economists, but they retain the conventional individual maximization procedures of the neoclassical model. Transaction costs play a central role in their analysis. Ronald Coase’s article on the theory of the firm (1937) is a seminal article for these neoinstitutionalists.

* It argues that firms develop because the transaction costs of the market are too high for interfirm transactions. Neoinstitutionalism is sometimes also called rent-seeking analysis or neoclassical political economy. Its proponents contend that rational individuals try to improve their wellbeing not only within a given institutional structure but also by changing that structure. Economic analysis, they contend, must include a consideration of the forces determining that institutional structure
* An equilibrium institutional structure is one in which it is not worthwhile for individuals to expend further effort to change the institutions. Only on the basis of an equilibrium institutional framework, they say, can one produce relevant analysis. These neoinstitutionalists argue that a competitive institutional structure is unstable, because some individuals have a strong incentive to change the institutional structure to benefit themselves, and this incentive is not offset by incentives to support a competitive structure. Perfect competition loses out in the competition of institutional structures. Accordingly, neoclassical economics is irrelevant, not because of its maximizing assumption but because its assumed institutional structure is not an equilibrium institutional structure. The maximization assumption has not been carried far enough.

**2.2.2Quasi- Institutionalists**

The institutionalists and who were strongly influenced by them, but who are too individualistic and iconoclastic to fit the institutionalist mold. These include Joseph Schumpeter, Gunnar Myrdal, and John Kenneth Galbraith.

1. **Joseph Schumpeter**

* Schumpeter came to the United States in the early 1930s and taught at Harvard, hardly a hotbed of heterodoxy. Yet he befriended the young Paul Sweezy; and although Schumpeter was clearly a conservative and not a Marxian, he acknowledged the power of Marx’s vision of historical change. One element in Schumpeter’s heterodoxy was a lack of interest in the equilibrium focus of neoclassical theory. He concerned himself instead with the dynamic aspects of theory, as manifested in The Theory of Economic Development (1912) and Business Cycles (1939), and especially in the delineation of the entrepreneur, a key figure in all of his analysis.
* Schumpeter, who like many heterodox economists painted with a broad brush, found the very abstract model of orthodox theorists too limiting. He continuously demonstrated the heterodox proclivity of drifting outside the intellectual boundaries of neoclassical theory, as he poached on the preserves of sociology, history, and political science. Although he unflinchingly declared his interest in and support of the orthodox paradigm, in his work he ignored the practices he advocated. For example, he avidly supported greater use of mathematics and econometrics in economics, but his own work was almost completely devoid of these orthodox tools.

* His plan was to show how there has been a steady progression from error to greater and greater truth. However, the book is not a history of economic analysis but a history of economic thought. Nevertheless, Schumpeter is complex, multifaceted, and in his own way mainstream; this is reflected in the fact that he reserved his highest honors for those economists who created modern, abstract general equilibrium theory. Schumpeter formed no school to carry on his economics, but his dynamic approach to economic institutions and development is reflected in the work of different authors.

1. **Gunnar Myrdal**

Our second quasi-institutionalist is Gunnar Myrdal (1898-1987), one of many Swedes who have made important contributions to economics.

* Myrdal came to be an international figure whose interests led him to study economic policy issues around the world, though early in his career he was more interested in technical questions of pure theory. Myrdal is critical of orthodox economic theory, yet his criticism is not as strident as that of Veblen, Commons, or Hobson. Temperamentally more like Wesley Mitchell, he objects quietly and then busies himself with the tasks at hand. His major criticisms of orthodox economic theory center on the role of value judgments in theory, the scope and methodology of theory, and the implicit laissez-faire bias of theory. Myrdal maintains that attempts by orthodox theorists to develop a positive science, free of normative judgments, have failed. The orthodox attempt, he asserts, merely produced a body of propositions in which normative judgments were implied but never made explicit. Yet economists are and should be interested in questions of policy, Myrdal points out; thus, their choice of subjects to study and methods to use will necessarily reflect value judgmentsEconomists could then use this positive, value-free body of knowledge in conjunction with the normative values implicit in any given set of goals to make policy. Facts do not organize themselves into concepts and theories just by being looked at; indeed, except within the framework of concepts and theories, there are no scientific facts but only chaos. Questions must be asked before answers can be given. The questions are an expression of our interest in the world, they are at bottom valuations. Valuations are thus necessarily involved already at the stage when we observe facts and carry on theoretical analysis, and not only at the stage when we draw political inferences from facts and valuations. I have therefore arrived at the belief in the necessity of working always, from the beginning to the end, with explicit value premises. The value premises cannot be established arbitrarily; they must be relevant and significant for the society in which we live.
* A second criticism leveled by Myrdal against orthodox theory concerns its scope and method. In common with many other heterodox economists, he maintains that economics is too narrowly defined by orthodox theory. Myrdal wants to bring into his analysis material from all the social sciences, particularly psychology and sociology. He also criticizes the focus of economics on short-run issues, whether they involve the allocation of resources or fluctuations in economic activity. Myrdal is more interested in the longer-run questions concerning economic growth and development and believes that much of the analytical framework and concepts of orthodox theory are inappropriate for this task. Myrdal finds the orthodox fixation on equilibrium particularly inappropriate in trying to explain the economic, social, and political changes taking place throughout the world. He abandons the static equilibrium analysis of conventional theory and develops instead a notion of cumulative causation.
* His idea of cumulative causation is, in essence, a general, dynamic equilibrium framework in which the term general implies that other than purely economic factors enter the analysis. This idea will be demonstrated later with an example from Myrdal’s analysis of the economics of underdevelopment. Finally, Myrdal is critical of what he regards as the bias of orthodox theory, which assumes that there is harmony in the system and that laissez faire is therefore the best policy for all nations to follow, regardless of their stage of economic development. Myrdal views the long-run development of the Western industrialized nations as passing from a period of mercantilist governmental controls to a period of liberalism and laissez faire, to a period of welfare politics in which governments intervene on a more or less pragmatic basis to ease pressing social problems, to a final period of planned economy, which has not yet been reached by some industrial countries, particularly the United States. The end of laissez faire is marked by increasing government involvement and intervention on a piecemeal basis, with no overall coordination. Present experience, according to Myrdal, reveals the necessity of planning the macroeconomic goals of the economy and letting the market and, for the most part, private enterprise allocate resources within this plan. Without the overall planning to take us beyond the welfare state, he says, we will have an economy characterized by inflation, unemployment, and balance of payments difficulties. Myrdal’s model of planning is not that of Soviet economics, nor is it as complete as indicative planning. It supposes national planning of the macroeconomic variables with a minimum of bureaucracy and maximum decentralization of economic decision-making. Looking into the future, Myrdal sees the need to extend planning to the international level so that the fruits of the Industrial Revolution can be extended to everyone as we achieve a global welfare society.
* Myrdal took an interest in underdeveloped countries and the world economy as well as in the special problems of affluent economies. Myrdal maintains that there is a widening gap in real income between the rich and poor nations. Orthodox economic theory has no satisfactory explanation for this widening gap, nor does it offer any suitable policies to reverse these trends. The definitions economists use are too narrow, and the models for economic development are in the basic tradition of static- equilibrium models; they fail to grasp the complex interrelationships among economic, sociological, political, and psychological factors that mold economic development. Myrdal argues that in order for anyone to understand economic development, “history and politics, theories and ideologies, economic structures and levels, social stratification, agriculture and industry, population developments, health and education, and so on, must be studied not in isolation but in their mutual relationship. The orthodox theorist believes that increased capital formation will lead to economic growth and therefore concludes that an unequal distribution of income is desirable, because it will result in less aggregate consumption and more saving and investment. Yet this is too narrow a view of the concept of investment. Myrdal contends that labor efficiency is very low in underdeveloped countries partly because of all the evils associated with poverty. Increased consumption for the laboring classes, he contends, will therefore lead to better health, greater productivity, and better attitudes toward work. Thus, what an orthodox economist would call consumption expenditure is in this case an investment in human
* The failure to define expenditures in terms of their impact on productivity “is one reason for doubting the usefulness for South Asia of Western-type economic models which stress the relationships among output, employment, savings, and investment.”, Myrdal believes, has failed to recognize the necessity of planning its economy, in spite of the obvious social and economic costs of not planning. And the underdeveloped countries cannot afford the luxury of evolving planning systems in the manner of the Western European countries—the stages of laissez faire, piecemeal intervention, and then national planning. The poor countries must begin, Myrdal reasons, with comprehensive national planning, if they hope to stimulate their static, past-bound, stagnant economies, to solve their population problems, and to significantly increase their per capita incomes so as to promote the long-cherished Western ideal of social justice.

1. **John Kenneth Galbraith**

John Kenneth Galbraith (1908- ) represents the first American economist since Veblen to be widely read by intellectuals among the general public. An unusually gifted writer, he has published a number of books on subjects outside the scope of economics as well as many in that field. Like many other heterodox writers, Galbraith has offered a criticism of accepted economic theory without providing a well-defined and logically consistent alternative. He long ago gave up trying to change the profession; he does not seem to care whether or not any new theoretical structure emerges to conform to his vague, tentative formulations.

* Competition as the regulatory mechanism of the economy, then, has been superseded by countervailing power, says Galbraith. Like competition, countervailing power is a selfgenerating regulatory force: power arising at one point in the economy begets a countervailing power. Galbraith then proceeds to give examples of this hypothesis: the growth of large corporations led to the growth of powerful unions in the same industry; the power of the large manufacturer was countervailed by the power of the large retailer; and the continuing government policy has facilitated the growth of countervailing power.
* The orthodox theory that equates monopoly power with illfare, Galbraith says, is wrong. The self-generating character of countervailing power results in an economy shot through with monopoly power, but one that nevertheless produces welfare for its society. Galbraith’s invisible hand has replaced Adam Smith’s invisible hand. He does note one significant case in which countervailing power does not operate: “It does not function at all as a restraint on market power when there is inflation or inflationary pressure on markets.” During these periods, the powerful unions and corporations find that “it is to their mutual advantage to effect a coalition and pass the costs of their agreement along in higher prices.”
* Galbraith begins with another attack on orthodox theory and, phrasemaker that he is, coins a term to apply to theories he rejects: the conventional wisdom. Because the conventional wisdom of orthodox price theory was formulated at a time when societies were concerned about providing basic necessities, the theory focuses on scarcity. Observation of the American economy reveals, however, that for the most part we have solved the problem of scarcity and are now providing, in the private sector of the market, goods of a low order of urgency. Galbraith finds it interesting that as our production of goods has increased, our concern for producing even more goods has increased as well. Part of the reason for our fixation on production, for our GDP cult, is that the problems of unequal distribution of income, individual insecurity, and depression are relieved or solved by an ever-growing output. But the primary reason is that consumer wants are manipulated by the producers so that consumers feel a deep need for the products of an affluent society. Orthodox price theory assumes that individual consumer wants are given; they come from within the individual. It is the sovereign consumer that directs the allocation of resources to meet his or her needs. Galbraith maintains that this theory is not applicable to the modern affluent society, in which producers create the desire for their products. The process by which “wants are increasingly created by the process by which they are satisfied”Galbraith terms the dependence effect. The proposition that consumer wants are for the most part created by producers through the dependence effect does serious damage to orthodox price theory. It demands, in fact, that the entire theory of consumer behavior be rewritten and that the notion of consumer sovereignty be completely exploded. Concern for production and economic growth is seen to be misguided. “One cannot defend production as satisfying wants if that production creates wants.” Generally using this dependence effect
* The utilization of modern technology requires large-scale firms. With the growth of these firms has come a separation of ownership and control; those who control firms are paid managers who form part of the technostructure of the society. In order to avoid risk and eliminate uncertainty, the firms encourage the government to stabilize the economy; they cooperate with unions; they invest out of retained earnings as much as possible; but above all they manage the preferences of consumers. Although this involves planning, firms do not plan in order to maximize profits, as is assumed by orthodox price theory; their primary goal is continuity of operation or survival of the firm. Once the firm achieves this security, it begins to think about growth in sales. Thus, Galbraith extends and amplifies his concept of the dependence effect—that wants are created by the process by which they are satisfied—to show (1) that the growth of technology and large-scale firms has created a necessity for order in the economy with a minimum of risk and uncertainty; and (2) that planning, which includes the management of consumer preferences, is now an essential part of the economy.
  + 1. **POST-KEYNESIANS**
* In post-Keynesian work as a whole, one sees a consistency of conceptualization, if not of models. An enduring concept is that the economy is not stable: the invisible hand of the market does not work as well as neoclassical theory suggests. It follows that post-Keynesians see a much stronger role for government action in correcting the problems of capitalism than does orthodox theory. Post-Keynesians are best known for their support of tax-based incomes policies (TIP).
* In developing the post-Keynesian role of money, they emphasizes the existence of irreversible time and true uncertainty, which cannot be reduced to a probability distribution and hence cannot be changed to risk and then to certainty equivalents. These two interrelated characteristics of the economy have “led man to develop certain institutions and rules of the game, such as (i) money, (ii) money-contracts and a legal system of enforcement, (iii) sticky money-wage rates, and (iv) spot and forward markets.” Thus, institutions change the way in which the macroeconomy operates.

**AUSTRIAN ECONOMICS**

Austrian economists parted company from the mainstream for much the same reason that post-Keynesians did—the formalization of economics, which, they argue, has lost or abandoned many insights of earlier writers. Until 1960, Austrian economics was considered part of the mainstream; but as neoclassical economics faded and mainstream economics opted for formal model building, the Austrians reemerged as dissenters. This is not to say that they did not have differences; they had substantial differences with the mainstream even then. For example, the Austrian analysis of production sees capital as an intermediate good that can be understood only in stages of production analysis. Similarly, Austrians maintained a steadfast adherence to viewing individuals as purposeful actors, not as a type of utilitarian machine that reacted to pleasure or pain. This, in part, led to a strong Austrian emphasis on entrepreneurship. They also maintained a different approach to costs, which they saw as individually subjective, rather than being objectively determined as in the classical school and in some interpretations of neoclassical cost analysis. These differences, while substantial, did not place Austrians out of the mainstream until the 1960s. But in the 1960s, with (1) the increasing formalization of economics; (2) the almost total dominance of the mainstream by general equilibrium theory; and (3) the increasing tendency for mainstream economics to see itself as a science in which truth is determined solely by model building and econometric testing, Austrian economics departed from the mainstream.

* A central Austrian economic theme is that economic analysis is a process, not a static interaction of individuals, and that time is an essential consideration. It sees competition as a dynamic process through which high profits are eliminated over time. But those high profits play a very important role in driving the system.
* In Austrian economics, individuals are assumed to operate in a changing environment in which information is limited and the future unknown. The most interesting analysis, in their view, derives from studying not equilibrium itself but the process through which individuals grope toward equilibrium, a process that emphasizes the entrepreneur and that neoclassical economics calls disequilibrium.
* Until recently, there were strong political overtones in Austrian economics. It remains difficult to find an Austrian who is not a conservative; most simply assume the market is desirable and necessary for achievement of individual freedom. Many Austrians themselves, however, would characterize their political views not as “conservative” but as “radical libertarian” or “anti-statist.” They argue that such views follow naturally from a study of history. Austrian economists object, from time to time, to econometric work and attempts to prove economic theorems empirically. Following von Mises’s “praxeology,” they perceived their task as one of deriving conclusions deductively from the logic of human action.
* Conclusions and theories thus derived need not be tested, in their view, because truth had already been logically established. Recently, however, they have taken a somewhat more conciliatory position, arguing that it is the type of empirical work mainstream economics does—which does not include historical and heuristic elements—that is inappropriate