

**The Emergence and Evolution of Institutions:
The Complementary Approaches of
Carl Menger and Thorstein Veblen¹**

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Abstract:

This paper is an attempt to compare Carl Menger and Thorstein Veblen,'s conceptions of institutions. It is shown that although Menger stresses on the emergence of institutions, Veblen is much aware of analyzing their evolution. On this basis the idea of a dialogue between the two authors is propose and its characteristics are presented.

Keywords: Menger, Veblen, institutions, evolution, emergence

JEL codes: B13, B15, D02

Introduction

A number of works have attempted to establish a dialogue between the Austrian and Institutionalist Schools, whether to bring out thematic propinquities (Samuels, 1989²; Wynarczyk, 1990), conceptual complementarities (Vanberg, 1989)³, or hardly reconcilable oppositions (Hodgson, 1989).

There are two types of difficulty in attempting to establish a dialogue between Austrians and Institutionalists.

The first difficulty is linked to the necessity to previously define the ‘theoretical sets’ we wish to compare. In fact, if we undertake to bring to light the common elements between Austrians and Institutionalists, it is first necessary to determine what make a specific author, or a given conception of economic phenomena related to one of these two sets. Numbers of works have attempted to identify ‘Schools’, ‘Research Programmes’, ‘Research Traditions’, ‘Paradigms’, when others showed the non-homogeneous character of both trends of thought⁴. In order to reduce the impact of this first difficulty, we shall focus the comparison on the respective contributions of Menger and Veblen.

The second difficulty arising from the establishment of such a dialogue lies in the fact that it presupposes *i*) a common language, or at least the possibility of building such a language, and *ii*) common problems which may be used as a basis for this dialogue. The first of these conditions refers to conceptualisation, while the second relates to the existence of a common problematic. Actually, the difficulty is that these Schools do not set out the problem in the same way and the issue of institutions thus does not come within the same context. Within the framework of a paradigmatic vision of the evolution of scientific knowledge, we would say, after Kuhn (Kuhn, 1962), that the incommensurability of paradigms makes all conceptual comparison ineffective (Feyerabend, 1975).

Indeed, while the Institutionalists consider that all reflection on the nature and the evolution of institutions is necessary to understand the dynamics of individual behaviours, the Austrians attempt to explain how institutions emerge unintentionally from the dynamics of individual behaviours. If the former study the evolution of already existing institutions, the latter look into their origin⁵.

Thus, the debate can only be sterile if, like the former, we consider that the individuals behave within a pre-existing framework which the logic of alteration it is essential to study and, like the latter, that the origin of institutions may only be analysed on the basis of individual actions.

So it is relevant to solve, within the scope of economics, this difference in problem identification which results in diverging views on the importance and the role of a reflection on institutions.

For Menger, who comes within the Smithian perspective, it is essential to set out the problem as follows: how is it that individuals produce an order and institutions though they do not necessarily behave and consult each other with this aim in view? For Veblen, the problem consists in explaining why individual actions show some consistency, that is to say why they do not diverge *a priori*.

Is it conceivable to reconcile these two views? In other words, can we consider setting out the issue of institutions in such a way that we may explain both their origin and the nature of their evolution? To this end, we need to know whether it is possible to reconcile the logic of emergence of institutions with the logic of their running.

Endeavouring to formulate such a problem is of relevance if we consider that the institutional framework is a factor of the innovative dynamics and more generally economic changes (Ménard and Shirley, 2005). In this perspective, analysing the evolution of this framework constitutes an important theoretical issue. It then seems pertinent to examine the factors which account for the emergence and evolution of institutions.

We shall proceed to answer all of the above-identified questions in two phases. In a first part, we shall present Menger and Veblen's conceptions of institutions. This will then

allow us to study, in a second part, the possibilities of a dialogue about institutions between these two authors.

I. Menger and Veblen's Conceptions of Institutions

Without going into our future developments, Veblen and Menger have one thing in common, *i.e.* they refuse any approach which would exclude time as a main factor of economic analysis in general, and of the analysis of institutions in particular. This has permitted to consider that both had an evolutionary conception of institutions. Our presentation of their works will therefore focus on this aspect of their approaches to institutions.

Menger's Conception of the Origin of Institutions

Menger, the founder of the Austrian School of Economics, considers that one of the main tasks – if not the main task – of economists is to explain the origin of institutions (C. Menger, 1883, 1963). Langlois thus writes that “C. Menger's most important contribution to economic science was his theory of social institutions” (Langlois, 1989, p. 278). When he undertakes to ‘de-homogenise’ Walras, Jevons and Menger, Jaffé (1976) describes strangely Menger as an Institutionalists.

The Foundations of Menger's 'Evolutionary' Analysis

Mengers' conception of institutions comes within the scope of a distinction between the exact and realistic-empirical orientation of research in economics⁶. While the latter aims at establishing regularities between real phenomena, the former, which, for Menger, corresponds to a really scientific approach, strives to discover the essence of economic

reality, that is to say the ‘strictly typical relationships’ between ‘strictly typical phenomena’. In opposition to the critics levelled by the supporters of the ‘historical method’, exact theory, even if it tends to identify typical relationships between typical phenomena, is not synonymous with ‘timeless’ analysis. On the contrary, its aim is to explain the genesis of phenomena: “This genetic element is inseparable from the idea of theoretical sciences” (Menger, 1963, p. 94).

“Exact theories are supposed to reveal to us the simplest and strictly typically constituent factors (susceptible to exact inquiry) of phenomena and the laws according to which complicated phenomena are built up out of the simplest factors. However, they fulfil this task completely only by providing us with this understanding in respect to each phase of the development of phenomena. Or in other words, they do so by teaching us how phenomena are presented at *each step of their development* as the result of a regular genetic process” (Menger, 1963, p. 113).

Thinking that the exact orientation of research does not integrate a ‘historical point of view’ therefore constitutes a methodological error, and Menger’s opinion is that the supporters of the German Historical School, when they criticise this orientation and assert the necessity of founding economics on the historical method, mix historical ‘method’ up with historical ‘point of view’. It is on this basis that Menger elaborates his conception of the origin of institutions.

The Origin of Institutions: the Scope and Limits of an Analogy between Natural Organisms and Social Institutions

For Menger, there are a number of similarities between natural organisms and social structures. Both are characterised by the existence of interdependence relationships between parts and whole.

“In natural organisms we can observe a complexity almost incalculable in detail, and especially a great variety of their parts (single organs). All this variety, however, is helpful in the preservation, development, and the propagation of the organisms as *units*”...“We can make an observation similar in many respects in reference to a series of social phenomena and human economy in particular” (Menger, 1963, pp. 129-130).

If we now look into the origin of these two types of real phenomena – *i.e.* natural organisms and institutions –, we can notice another similarity: like for natural organisms, some social structures emerge and function without them arising from any conscious will. These analogies have significant repercussions on the analysis of social phenomena in general, and of institutions in particular.

“Now if social phenomena and natural organisms exhibit analogies with respect to their nature, their origin, and their function, it is at once clear that this fact cannot remain without influence on the method of research in the field of the social sciences in general and economics in particular” (*idem*, p. 130).

However, this system of analogies must be put into perspective as regards its actual content. Indeed, first, some social institutions do not respect the analogy: ‘pragmatic’ or ‘mechanical’⁷ institutions which are the result of a deliberate calculation, of a collective will. Second, the parts of a natural organism participate automatically – or more exactly without specific behaviour – in the constitution and evolution of the whole, while it is not the same for the creation of social institutions.

“They are, rather, the result of human efforts, the efforts of thinking, feeling, acting human beings” (*idem*, p. 133).

Thus, the scope of the analogy is considerably limited. The analogy, reduced to the only dimension of the origin of phenomena, will be justified only for these institutions which are the unintentional result of individual actions. Menger refers in this case to ‘organic’ institutions. As regards pragmatic institutions and as far as the other dimensions of organic institutions (nature and function) are concerned, the analogy will be erroneous. For Menger, the ‘organic’ approach to the origin of institutions may be conducted within the framework of an exact orientation of research.

“The acknowledgement of a number of social phenomena as ‘organisms’ is in no way in contradiction to the aspiration for exact (atomistic!) understanding of them” (Menger, 1963, p. 141).

Menger thus rises up against the collectivist analysis of institutions which regards them as units having an origin and evolution which the study of these constituents’ behaviours does not manage to explain. He does not call into question the unity of these

social structures, but he rather considers that the exact orientation of research in economics is in a position to explain their origin and functions.

“What the exact orientation of research strives for is on the one hand the clarification of the ‘unity’ of those structures which are designed as social organisms. On the other, it strives for the exact explanation of their origin and their function” (Menger, 1963, p. 143).

Language, religion, the State, and in the economic field, the market, competition, money, are unintentionally created social structures which the exact orientation of research can explain.

In fact, Menger uses exact orientation as a basis to criticise the ‘organicist’ and ‘collectivist’ approaches to institutions. Institutions like money and the market are not organic in the sense that they would exist right away as units and would evolve as such.

The Process of Emergence of ‘Typical Behaviours’

Menger’s proposed example on the origin of money will enable us to clarify this aspect. In a paragraph of *Problems of Economics and Sociology*, in a chapter of *Principles of Economics*, and in an article *The Origin of Money*, Menger puts forward a specific conception of the origin of money. He shows that there is a fundamentally dynamic process leading to the emergence of a currency. Though he does acknowledge that some currencies may have been the result of a deliberate creation (for example in the colonies), he considers a difference should be established between the origin of money, regarded as an unintentional institution, and its evolution. Thus, after its creation, a

currency takes the form of a 'rule' which applies to all. Here we find the idea of a "reciprocal conditioning of the whole and its normal functions and the parts" (Menger, 1963, p. 147).

It is essential to make a distinction, as mentioned in the introduction, between the origin and the evolution of institutions in general and 'organic' institutions in particular. We shall go back over this aspect of the Mengerian thinking later on.

As far as the origin of money is concerned, Menger takes a barter situation as his starting point. The individuals exchange goods according to their respective needs. But the goods are more or less exchangeable on a market⁸. In view of this, the individuals will be inclined to exchange their possessions for goods which may be exchanged for a greater number of other goods. They will thus progressively come to select, amongst the most exchangeable goods, one which will be accepted by all in their exchange operations. The creation of a currency, which results from the fact that less exchangeable goods are exchanged for more exchangeable goods, is therefore interesting for all individuals. However, a currency will only exist if the individuals understand that their interest, which *a priori* consists in exchanging their possessions for goods they need, is actually to get more exchangeable goods through exchange. Here Menger uses the following argument: the individuals gradually come to emulate – because they little by little find it to their own advantage – those who agree to exchange goods for more exchangeable ones, insofar as direct bartering would not enable them easily to get goods that are immediately useful to them. Resorting to this type of 'staggered' exchange brings any individual closer to his ultimate design, *i.e.* the satisfaction of his needs. Menger thus concludes his analysis on the origin of money:

“Money, an institution serving the common good in the most outstanding sense of the word, can thus, as we saw, come into being legislatively, like other social institutions. But this is no more the only way than it is the most original way that money developed. This is rather to be sought in the process described above, the nature of which would be explained only imperfectly if we wanted to call it ‘organic’, or if we wanted to designate money as something ‘primeval’, ‘original’, etc. It is clear, rather, that the origin of money can truly be brought to our full understanding only by our learning to understand the *social* institution discussed here as the un-intended result, as the unplanned outcome of specifically *individual* efforts of members of a society” (C. Menger, 1963, p. 155).

This example illustrates perfectly the Mengerian conception of the origin of institutions. Indeed, the specific knowledge individuals have of their environment and their will to satisfy their needs at best drive them to enter into a learning process which progressively leads them to select a good that can be exchanged for all others, even though there is no collective will in action.

We may derive the following propositions from Menger’s arguments:

- 1) When a currency is selected, it establishes itself as a ‘rule’. So, on the one hand, it looks as if it had been imposed by a single will and, on the other hand, it cannot be subject to revision. No individual will is in a position to call into question the choice resulting from the selection process.
- 2) It is not possible to know, *a priori*, which good will be selected. In fact, on the one hand, a currency does not exist as long as the selection process is not completed and, on the other hand, the physical characteristics of a good do not intervene, as such, in the

process of its progressive selection. It is the history of the exchangeability of a good – which alters in the course of the selection process – that conditions its future exchangeability. Menger illustrates this ‘genealogy’ of money when he writes that the German term ‘geld’ comes from the verb ‘gelten’, which means ‘to compensate’.

3) At the very beginning of the process, the distribution of the individuals’ choices over all of the goods depends on their needs as well as on the way they think they can satisfy them. The first choices are even more determining when they give rise to an important imbalance in favour of a specific good, that is to say when a high number of individuals choose it.

4) The individuals’ evolution of and change in exchange behaviours have a cognitive origin. It is through the medium of a learning process – which Menger sometimes confines to mere emulation – that the individuals alter their preferences as regards the goods they wish to exchange.

The relative weakness of Menger’s analysis, which compels us to introduce another type of approach, lies in his treatment – or more exactly in his non-treatment – of the evolution of institutions. Indeed, if he clearly explains the origin of institutions, he is not so explicit on the period which follows this creation. Furthermore, unintentionally created social institutions are, for Menger, fit to satisfy everyone’s well-being (social welfare): in other words, they are the most in a position to solve problems of coordination in an optimal way. However, as Schneider writes in his introduction to the American edition of *Untersuchungen über die Methoden der Socialwissenschaften und der Politischen Oekonomie insbesondere*:

“When Menger answers his question about the rise of unplanned functional institutions and points to the fact that out of the pursuit of individual interests ‘happy’ social circumstances may arise, there is still much that he leaves untouched and with which one would have liked to see him concerned” (Schneider, 1963, p. 12).

The institutionalist approach seems to us pertinent here, and perhaps even complementary. Indeed, on the one hand, Veblen emphasises the selection process of institutions and, on the other hand, he criticises the assertion according to which institutions would be fit to satisfy social welfare.

Veblen and the Evolution of Institutions

Veblen’s analysis of institutions is linked to his will to conceive an evolutionary economic theory. Thus, the criticism he levels at ‘classic’ economic theory is that it boils down to a taxonomical system and is, on this basis, pre-Darwinian (Veblen, 1898)⁹. However, Veblen’s analysis of institutions cannot be apprehended without referring to the pragmatic anchorage which characterises the ‘Old Institutional Economics’.

The Pragmatic Foundations of the Veblenian Evolutionism

This philosophical inspiration permeates all of Veblen’s works and enriches the evolutionary methodology which he regards as the paradigm of new science¹⁰. He espouses Darwin’s views that science has to search for causality in the social realm, that social as well as natural evolution is the key element scientists have to deal with and

that individuals are not rational calculators willing to satisfy their own desires are embedded in the social world and act on the basis of habits of thought that this embeddedness creates. All those elements are common both to Darwin and the pragmatists. “Although Veblen rarely spelt out such matters in sufficient details, I submit that this pragmatist conception of action is entirely consistent with his own expressed views, and its adoption is explicable in terms of knowledge of the ideas of Charles Sanders Peirce, William James and John Dewey.” (Hodgson, 2004a, p. 350). On the one hand, the nature of the relationships between the preconceptions of economic science and the particular circumstances which produce them and, on the other hand, the evolution of these preconceptions permit to make explicit the pragmatist foundations of Veblen’s evolutionism. He thus writes:

“For this purpose it may be sufficient to point out that the preconception in question belongs to the generation in which the Physiocrats lived, and that it is the guiding norm of all serious thought that found ready assimilation into the common sense of that time” (Veblen, 1899, p. 133).

Veblen is certainly aware that the Physiocratic anchorage in a natural order endures, but he considers that this persistence constitutes a version of it which may be described as ‘denatured’ insofar as it does not tally any more with the present circumstances. So, with regard to the break which Hume introduces in this view of things, he thus points out:

“To explain the characteristic animus for which Hume stands, on grounds that might appeal to Hume, we should have to inquire into the peculiar circumstances – ultimately

material circumstances – that have gone to shape the habitual view of things within the British community, and that so have acted to differentiate the British preconceptions from the French, or from the general range of preconceptions prevalent on the Continent” (Veblen, 1899, p. 136).

Defining preconceptions within the scope of “peculiar circumstances” expresses the consubstantial nature of the concepts and perceptions, that is to say the fact that we “hang perceptions on concepts, and concepts on perceptions, without distinction and indefinitely” (James, 1926, p. 132). This is summed up in the following “pragmatic formula”:

“The pragmatic formula lays it down that the meaning of a concept can always be found, if not in some particular sensory reality which it serves to designate, at least in some characteristic of human experience which its existence will make true” (James, 1926, p. 75).

So, the explanation of a divergence between the English and French preconceptions does not rest on a difference in terms of reality, but in terms of relationship with this reality. It therefore needs to be evaluated in view of the specific modes of cultural learning.

“Divergence is visible in the higher syntheses, the methods of handling the material of knowledge, the basis of valuation of the facts taken up, rather than in the material of knowledge. But this divergence must be set down to a cultural difference, a difference of point of view, not to a difference of inherited information. When a given body of

information passes the national frontiers it acquires a new complexion, a new national, cultural physiognomy. It is this cultural physiognomy of learning that is here under inquiry” (Veblen, 1899, p. 138).

This pragmatic inspiration permits to identify the Veblenian unit of the selection process.

The Unit of Selection

For Veblen, if economics means to be an evolutionary science, economic action must constitute its subject. But this economic action does not solve itself through the Hedonistic impulse which the economists retain to found the *homo economicus*.

“He is not simply a bundle of desires that are to be saturated by being placed in the path of the forces of the environment, but rather a coherent structure of propensities and habits which seeks realization and expression in an unfolding activity. According to this view, human activity, and economic activity among the rest, is not apprehended as something incidental to the process of saturating given desires” (Veblen, 1898, p. 390).

This conception comes within the scope of a pragmatic view of human action. Veblen expresses it when he writes:

“The activity is itself the substantial fact of the process, and the desires under whose guidance of action takes place are circumstances of temperament which determine the specific direction in which the activity will unfold itself in a given case. These

circumstances of temperament are ultimate and definitive for the individual who acts under them, so far as regards his attitude as agent in the particular action in which he is engaged” (Veblen, 1898, p. 390).

For Veblen, the analysis of change rests on the notion of ‘cumulative causation’. Analysing the history of human actions thus entails identifying the body of determinations acting upon them. It is all of the habits of thought that form the content of this body.

“The base of action – the point of departure – at any step in the process is the entire organic complex of habits of thought that have been shaped by the past process” (Veblen, 1898, pp. 392-93).

The evolution of institutions therefore permits to explain the history of human actions insofar as these are determined by habits of thought. Selection then applies to institutions. And institutions constitute units of selection. Veblen thus refers to a selection of the habits of thought that are deemed fittest to enable the individuals to adapt to environmental changes. So, it is the analysis of the selection process of institutions that constitutes one of the theoretical issues of the Veblenian approach.

The Selection Process

For Veblen, the unit of selection is also a factor of selection. Hodgson observes it full well when he writes that, in the Veblenian approach, “institutions are both replicators

and the units of selection in socioeconomic evolution” (Hodgson, 1992, p. 288). Veblen thus writes:

“Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; they are at the same time special methods of life and human relations, and are therefore in their turn efficient factors of selection. So that the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions” (Veblen, 1899, p. 188).

In this perspective, there is a process of reinforcement of habits of thought. What characterises this approach is in fact the assertion of a tendency to institutional inertia. For Veblen, behaviours are ‘routinised’, habits of thought are supervised by institutions. So there is a process of institutional reinforcement insofar as routine actions are inclined to repeat and strengthen what turns them into routine. Hodgson rightly refers to the works of Arthur (1989) on lock-in phenomena when he writes: “it would seem that the cumulative and self-reinforcing aspect of institutions and routines relates to some kind of process of positive feedback”...“Such lock-in phenomena can thus be regarded as sufficiently stable units of selection in an evolutionary process” (Hodgson, 1992, pp. 292-293).

The existence of a process which leads to this lock-in phenomenon is implicit in the reading which Rutherford makes of the Veblenian analysis of institutions. Indeed, as Rutherford underlines, beyond the external dynamics of institutions arising from the conflicting relations between institutions as crystallisers of habits of action and thought

and technological changes as ‘bringers’ of new habits of action and thought, institutions are the scene of an internal dynamics too (Rutherford, 1984). “Institutional systems do not, of course, spring fully formed from the start” (Rutherford, 1984, p. 334). On the one hand, institutional principles are inclined to ‘contaminate’ the other authorities of social reality. “In this manner any institutional system tends, over time, to become internally coherent and highly interrelated or ‘possessed of a certain systematic solidarity’” (*idem*, p. 334). On the other hand, there is the emergence of a process which, in the course of time, tends to induce a refinement of institutions. Finally: “institutional conventions come to find expressions in laws and constitutions and in particular organizational forms” (*idem*).

These three processes tend to give rise to a crystallisation of institutions – a lock-in phenomenon – which thus leads to increase institutional inertia. However, in Veblen’s approach, there is a tension between the different habits of thought which results in an institutional dynamics. Indeed, from the point of view of Darwinian evolutionism, selection presupposes a process which accounts for the variation in the units of selection, unless we consider there is a final end to evolution – which Veblen does not do, unlike Marx whom he may have criticised for doing so.

The Problem of Variation

In the analysis of institutions as units and factors of selection, there is a conception of institutional change coming into play. However, the evolutionary dynamics does not come within the framework of a dialectical conception of change¹¹. Veblen considers that men must adapt to industrial life insofar as their patterns of thought partly reflect their patterns of life, and that they must conform to the social, civic, military and

religious interests which do “not commonly coincide with the training given by industry” (Veblen, 1899, p. 143). It seems to us that a connection should be established between this pragmatic tension and the Peircean conception of modes of being. Peirce distinguishes three modes of being which he sums up as follows:

“Firstness is the mode of being of that which is such as it is, positively and without reference to anything else. Secondness is the mode of being of that which is such as it is, with respect to a second but regardless of any third. Thirdness is the mode of being of that which is such as it is, in bringing a second and third into relation to each other” (Peirce, 1978, p. 72).

In our view, the Peircean conception of the three modes of being is liable to serve as a foundation for Veblen’s evolutionary methodology, even if he does not explicitly refer to it in his approach to institutional changes. Man, as an acting being, is in actual contact with the world (*secondness*), which is supposed to have a potential existence (*firstness*). But the possibility of anticipating presupposes that this embeddedness in actuality is projectable into the future through laws which reveal the future features of secondness. For Peirce, *thirdness* is that which mediates between firstness and secondness, that which creates a ‘process’. This conception permits to found the theory according to which man is caught up in the world’s actuality when he thinks and acts, but these modes of thought and action do not result from a single adaptation. That is why *i)* there is a variation and selection in habits of thought, *ii)* human action is, for Veblen, the subject of the evolutionary economic science, and finally *iii)* the Veblenian methodology cannot be but holistic.

The weakness of Veblen's analysis of institutions is the parallel he draws between instincts and institutions. On the one hand, his analysis of instincts is particularly confused (Pribram, 1986); on the other, the connections he establishes between instincts, habits of thought and social institutions are not coherent (Walker, 1977). Hodgson underlines it when he thus writes about the link between instincts and institutions:

“But, as we have noted, this lack of sufficient explanation, alongside brilliant insight, is one of the frustrating and characteristic features of Veblen's writing” (Hodgson, 1989, p. 288).

Two things need however to be stressed. First as Hodgson points out “the validity or otherwise of this point should be a matter not of prejudice against the concept of instinct but of scientific investigation.” (Hodgson, 2004a, p. 353). Second institutions may be conceived as bundles of weighted instincts. Third, it might also be considered that idle-curiosity is an instinct that motivates discovery and novelty (Witt, 2008).

It seems however that this difficulty lies fundamentally in Veblen's very ambition. Indeed, Veblen endeavours to present a theory of the evolution of institutions, and not an analysis of their origin¹². What he means to show is how institutions are renewed, how they come into conflict, on account of their inertia, with the evolutionary necessities which technological changes bring about. Unlike Menger, it is not so much the origin of institutions which constitutes the centre of gravity of his analysis as the evolutionary logic which the institutions carry within them. If institutions constitute units of selection, it is inconceivable to produce a theory that integrates their absence.

That is why it may seem impossible, for Veblen, to build, on the basis of these foundations, a coherent theory which explains both the origin and the evolution of institutions.

We may sum up this exposition of Veblen and Menger's analyses of institutions as follows: the former looks into the evolution of routines while the latter attempts to explain the constitution of these routines. Veblen regards routines as the units of selection whereas for Menger, individual behaviours, or more exactly knowledge as a base for behaviours, are the units of selection, routine being only the result of selection. In the Austrian perspective, the variation is ensured by the assertion of the individuals' fundamental specificity in terms of knowledge, and so in terms of behaviour. In the institutionalist perspective, this institutional variation arises from the relationship between the evolution of the ways of acting and of thinking which the technological dynamics produces by modifying the individuals' modes of immersion into an instrumented reality and the internal dynamics of institutions.

Is it possible to reconcile these two approaches which are conflicting only if the origin and evolution of institutions are put on the same level?

The thesis we propose is the following: the setting-up of new institutions, coming into contradiction with the former ones, brings to light breaks in individual behaviours which progressively come to create a real *institutional paradigm*. On the basis of this institutional paradigm, a coherent set of institutions tends to be set up to the detriment of the former, without this selection process being either immediate or necessarily total. Old institutions may thus endure, which no longer constitute a 'stake' insofar as, first,

they are not likely to be replaced by any other and, second, they do not hamper the development of the institutions' deployment process. Finally, the old institutions' resistance capacity can limit the generalisation of new behavioural routines.

In our opinion, the above thesis does not seem to be incompatible with either the Mengerian or the Veblenian conception. We even consider that it is liable to solve the former conception's difficulty explaining the evolution of the institutions set up, and the latter conception's difficulty explaining how a new institution emerges.

Going deeper into this thesis will enable us to justify this viewpoint.

II. The Conditions of a 'Dialogue' between Menger and Veblen

While Menger's works come within an Aristotelian perspective, as shown by Kauder (1957), Veblen's theses are inspired by pragmatic philosophy. If we place ourselves at this level to compare the two authors, it then appears obvious that there is a fundamental incompatibility between the philosophical roots of their respective conceptions of institutions. If we place ourselves at the methodological level, we can see that Menger is a keen advocate of methodological individualism, while Veblen is generally viewed as having embedded his works in methodological holism¹³. So, if we evaluate the comparison between these two conceptions of institutions in view of the epistemological and methodological characteristics of Menger and Veblen's 'thoughts'¹⁴, and if we attempt a term-for-term comparison, that is to say level-for-level, of the epistemological, methodological and theoretical contents of these thoughts, the dialogue is only possible in terms of opposition.

However, there is the possibility of a dialogue if we consider that both theorists propose an evolutionary approach to institutions within which framework they develop an

analysis where *i)* each moment of the evolution of institutions is only intelligible according to all of the moments which preceded it, *ii)* irreversibility is an essential feature of this evolution, *iii)* it is impossible to anticipate the result of this evolution, and *iv)* evolution is a ‘self-supporting’ process. This means that the comparison must be evaluated not by referring to one or the other level at which solutions are brought, but in terms of the method which permits to analyse the process in its entirety. In this perspective, the dialogue is possible if we define an encompassing problematic where the logics of emergence and running of institutions are mobilised from the angle of an evolutionary approach to institutions.

How can this encompassing problematic be clarified?

When Menger explains the origin of institutions, he assumes that the individuals learn from the others’ behaviour and alter their actions accordingly. In that sense, Streissler is right to write: “the stress on informational content is one of the respects in which Menger was very modern” (Streissler, 1972, p. 432). According to him, the “Mengerian man” is always trying to enhance his knowledge.

“He is constantly trying to *increase* his knowledge, creating *social institutions* to gather information, empowering growing droves of middlemen to act on his behalf. Still less than about the present does he know about the future. Again and again Menger stresses the *time dimension* of goods and the amount of *uncertainty* this entails” (Streissler, 1972, p. 433).

This learning is yet possible only if the individuals have sufficient understanding of the other individuals’ action. It is therefore necessary, unless we solve the problem in von Mises’ way and suppose that human action is defined by a certain number of *a priori*

categories, to consider a common space of knowledge which permits this understanding. There is therefore no situation of absence of institutions, rules of thought. This observation allows us to define the status which is to be given to the Mengerian conception of the origin of organic institutions. As Vanberg quite rightly points out:

“It is not an attempt to account for the particular historical record of a specific case, that is, of a concrete historical example of institution. It is, rather, an attempt to provide some general theoretical understanding of the kind of process by which, in principle, the kind of institution that is to be explained could have emerged under conditions that can plausibly be assumed to have existed” (Vanberg, 1989, p. 339).

This common knowledge serves as a basis for the progressive selection of a typical behaviour, be it within the framework of an exchange of goods, spatial location, *etc.* There therefore is a set of institutions defined, which rests on the ‘lock-in’ of behaviours becoming routine, and any deviation involves a cost which may be described as irrecoverable. It is the irrecoverable nature of deviance cost which in fact accounts for the possibility of occurrence of deviant behaviours. The example of the Schumpeterian entrepreneur is exemplary here. Even if or because he is not the one who insures the risk which the implementation of a new productive combination entails, his behaviour is deviant. And the fact that he is emulated by his peers, through a learning phenomenon, gradually comes to generalise this deviant behaviour. In this connection, Perroux points out that in *The Theory of Economic Development*, Schumpeter does not give us a ‘theory of evolution’ (development), but a ‘theory of triggering’ (start-up) (Perroux, 1935, p. 121) – which justifies the fact of regarding

Schumpeter as an ‘Austrian’ here. The coverage of deviance costs is progressive and subject to the success of its generalisation.

The triggering of such behaviour thus serves as a germ for the deployment of an institution. Here we find a logic of emergence.

However, an institution will only establish itself if it is in a position to capture, in an incentive or repressive way, the behaviour of a sufficient part of a population. This phenomenon does not only induce a competition between individuals with specific behaviours, but also between institutions. The argument here is closely akin to the works of Veblen and, as Leathers (1990) underlines, of Hayek, which show that the unit of selection is a set of rules of conduct. Once behaviours become routine, selection no longer focuses on individual behaviours, but on routines. That is why we think, after Hodgson, that it is justified to regard routines as units of selection.

In the process of institutional evolution, it is therefore necessary to consider two logical moments, which are characterised by two different units of selection. The first relates to the selection of behaviours, that is to say that typical behaviours emerge progressively from the constitution of individual behaviours. The second refers to the competition between routines, namely between typical behaviours. It is the superposition of these two moments which seems to us likely to account for the institutional dynamics. Indeed it seems possible to sum up these arguments in saying that the key difference between Menger and Veblen is that Menger concentrates on the ontogenetic development of a single institution, whereas Veblen concentrates on the evolutionary selection (phylogeny) of different institutions¹⁵.

It is necessary to complete this description of the two moments of the institutional dynamics with a presentation of the reasons for the imbalance which the emergence of deviant behaviours constitutes. We have observed that, for Veblen, it is the tension between institutional inertia and new habits of thought, which technological evolution entails, that accounts for the process of replacement of institutions by others. For Menger, the economic dynamics, and especially the institutional dynamics, is the result of the irrepressible trend of knowledge progress.

“Nothing is more certain than that the degree of economic progress of mankind will still, in future epochs, be commensurate with the degree of progress of human knowledge” (Menger, 1976, p. 74).

This increase in knowledge rests on the existence of institutions which appear both as the conditions and consequences of it. We are confronted here with a self-referential process where the product of a system’s running contains production processes of the system itself. Veblen quite rightly emphasises the significance of this identification when he writes:

“The economic life of the individual is a cumulative process of adaptation of means to ends that cumulatively change as the process goes on, both the agent and his environment being at any point the outcome of the past process. His methods of life today are enforced upon him by his habits of life carried over from yesterday and by the circumstances left as the mechanical residue of the life of yesterday” (Veblen, 1898, p. 391).

It seems to us that the behavioural break, whose necessity we have asserted, must be introduced in the very space of that which conditions behaviours. Technological changes are in fact important insofar as they rest on new rules of action. The introduction of a new technology therefore presupposes the existence of knowledge-based anticipations which result in deviant behaviours. It is a break with routine which permits the emergence of behaviours compatible with this change. So it is in the space of actions – in that they express knowledge – that the origin of this break is to be sought. Indeed, asserting that technological changes bring about new rules of action does not tell us anything about the extent of the gap between the existing rules of action and those which technological changes entail insofar as the latter are already regarded as being in place.

It is in the space of the rules of action – in that they are linked to specific knowledge – that we should measure this gap, instead of deducing it from some authorities that impose themselves from the outside. So it is the progressive construction of new behaviours which permits to explain the institutional break. And it is the constitution of these behaviours which produces new routines. It is thus possible to explain, not only the replacement of a routine by another, but also the progressive formation of new routines.

Conclusion

In this text, I meant to show that the dialogue between Veblen and Menger is possible if we consider that their conceptions of institutions, which are fundamentally evolutionary, do not stand at the same moments of the analysis of institutions. Each of

these two conceptions solves a specific problem: that of the origin of institutions for Menger, that of institutional change for Veblen. Even if the two authors developed very different epistemological as well as methodological conceptions of economics and institutions, my view is that it is possible to ‘reconcile’ Veblen and Menger’s approaches if one defines an institution as carrying a typical behaviour and if we proceed to explain two logically distinct types of processes: *i)* the emergence of a typical behaviour amongst all of the behaviours and *ii)* the assertion of a typical behaviour amongst all of the typical behaviours. There is then a kind of two steps game, one where typical behaviours are selected, the second where one of these typical behaviours is selected.

Notes

¹ I thank Geoffrey Hodgson and Ulrich Witt for useful comments. I also thank the International Center for Economic Research for its financial support.

² Samuels has organised a symposium during which ‘Austrian’ authors (like Boettke) and ‘Institutionalist’ authors (like Rutherford) debated on the possibility and the content of a comparison between the Austrian and Institutionalist Schools. In “Austrian and Institutional Economics: Some Common Elements”, Samuels thus writes: “The objective of this paper is to identify certain characteristics and elements of thought and analysis which arguably are common to both Austrian and Institutional economics” (Samuels, 1989, p. 53).

³ In this text, Vanberg attempts to show how the theses of Commons and Menger are more complementary and compatible than conflicting.

⁴ Hayek (1968) thus alludes to several generations of the Austrian School. In their history of economic thought books, Schumpeter (1954) and Pribram (1983) refer to the Austrian School. O’Driscoll (1977) brings up the notion of paradigm to explain the victory of Keynesianism over the Austrians (in fact, the victory of Keynes’ ideas over those of Hayek). Wynarczyk (1990) uses the notion of Research Tradition, as developed by Laudan (1977), to characterise the Austrian and Institutionalist contributions. Rizzo (1982) has defined the characteristics of an Austrian Research Programme in a Lakatosian perspective. The works of Parsons (1990) or of Caldwell have shown the heterogeneousness of the Austrian thinking. As regards the Institutionalist School, there is a distinction between the ‘Old’ and the ‘New’ Institutional Economics (Hodgson, 1989; Langlois, 1986, 1989; Rutherford, 1989), but also the Neo-Institutionalist School. Perlman (1991) shows the fragmented nature of the Old Institutional School.

⁵ This assertion is mostly valid for Menger. It is less so for an author such as Hayek. On this point *cf.* Garrouste (1994).

⁶ For a precise analysis of this distinction, *cf.* Kauder (1957), as well as Hutchison (1981), Dufourt & Garrouste (1993), or Dos Santos Ferreira & Ege (1991).

⁷ The distinction which Menger makes between pragmatic and organic institutions does not relate to a difference in the conditions of their emergence, but actually to the distinction he makes between exact and realistic-empirical orientation. Indeed, though Menger does say there are social institutions which may be of a pragmatic nature, he insists on the fact that an explanation which regards social institutions as the unintentional result of individual actions is more satisfactory. This is to be connected to *i)* Menger’s absence of analysis on the origin of pragmatic institutions (he only gives one instance of such

institutions: the birth of money in colonised countries), and *ii*) the comment Vanberg makes when he defines the status of the ‘organic’ approach in Menger’s works (Vanberg, 1989). (For a presentation of this comment, *cf.* later on).

⁸ O’Driscoll quite rightly points out that, in *Principles of Economics*, the ‘theory of money’ follows the ‘theory of commodities’ (O’Driscoll, 1986, p. 608). That is why money, in Menger’s works, takes root in exchange.

⁹ He also includes the works of the Austrian School in his criticism which, for Jaffe, reveals Veblen’s poor knowledge, if not utter ignorance, of the works produced by this school of thought (Jaffe, 1976). Hodgson expresses a slightly different opinion but argues that Veblen unfortunately blends in his critics ‘neo-classical’ economics and the Austrian School: “Of course, he was off the mark to associate this picture with Austrian theorists such as C. Menger” (Hodgson, 1989, p. 261).

¹⁰ It is interesting to note some propinquity here between Menger and Veblen whose importance we shall underline later on. Indeed, the two theorists define methodological characteristics which apply to both social sciences and natural sciences. *Cf.* Veblen (1899, pp. 123-124) and Menger (1963, p. 59, note 18: “the contrast between the theoretical natural sciences and the theoretical social sciences is merely a contrast of the phenomena which they investigate from a theoretical point of view. It is by no means a contrast of method”).

¹¹ Concerning the relationships between Veblen’s thinking and Marxism, *cf.* Aron’s enlightening introduction to *Théorie de la classe de loisir*.

¹² As Hodgson points: “Veblen outlined the problem of reconciling human volition and causality but failed to develop an adequate and non-reductionist philosophical framework in which human intentionality, monism and causality could be reconciled; without reducing mind to matter, or matter to mind. In retrospect, a missing conceptual tool was an explicit and developed concept of emergence in the context of a layered ontology.”... “However, emergentist philosophy did not come to maturity until the 1920s, at the very end of Veblen’s life.” (2004a, 351). Hodgson (2004b) regrets that Veblen did not sufficiently make use of the theories of spontaneous order that American sociologists developed around 1900. Witt (2008) stresses that Veblen proposes a natural (genetic) explanation of the emergence of novelty but fail to give a cultural explanation of novelty.

¹³ Individualism and holism do not necessarily contradict. They do if we accept the following proposition: “*If* ‘wholes’ exist *then* they have distinct aims and interests of their own.” (Agassi 1975, 147).

¹⁴ Dufourt & Garrouste (1993) use the notion of ‘thought’ to characterise the system of coherences which exists between the epistemological, methodological and theoretical levels of an author’s intellectual system.

¹⁵ I thank Geoff Hodgson for giving me this idea.

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