

Neoinstitutional and Neoclassical Perspectives in Resource and Environmental Economics

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Neoinstitutional and Neoclassical Perspectives in Resource and Environmental Economics¹

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There are alternative philosophies and approaches to the economic description of natural resource and environmental use and regulation. Some natural resource economists take primarily a neoclassical view (e.g., Anderson, 1982), while others are evolving the Neoinstitutional perspective (e.g., Bromley, 1982). Are these views, quite different in their outlook and expected results, both appropriate under certain circumstances? Are either of these to be favored in certain settings? What circumstances and under what setting is one approach superior or inferior to the other? Where are the perspectives similar, and where are they different?

It is the immediate purpose of this paper to review, specify, compare and contrast the neoclassical and neoinstitutional views of the management, use, allocation, and conservation of natural resources. An attempt is made to answer the questions: Are the divergent views reconcilable? Can they be synthesized? Where do they overlap and where are they simply irreconcilable? The answers become useful in deciding the appropriate perspective and approach that must be selected to solve a natural resource related problem.

The ultimate goal is to improve communication and understanding among natural resource economists of all “ilks”, which should result in a better job of institutional and economic analysis. The sense of the paper is first to simply describe, compare and contrast the

¹This paper was written during the 1986-1987 time period while a member of the faculty at the University of Florida. This paper has not been published; it currently is being updated to reflect key pieces of the scientific literature published on this matter since the late 1980s.

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alternative views. Then, the emphasis is placed on reconciliation of the views, and the paper ends with implications, to aid in providing insights about future directions.

Comparison of Neoinstitutional and Neoclassical Perspectives

A summary of the areas where major differences arise in the neoinstitutional (NI) and the neoclassical (NC) views is presented in Table 1. Each of these major differences is discussed in turn in the following; but, first a definition. Some authors reserve the term “institution” for the set of working rules guiding a social system, while adding the term “organization”: for the actual entity (e.g., government agency) that results from the institutional setting (Bromley, 1982, p. 839). Others use the same term to mean both (e.g., Dugger, p. 901). This debate is not new: Commons used the term to mean “organization,” while Veblen apparently favored the working rules notion (Dugger, p. 902-902). The reader is simply cautioned there are differences here. We do not attempt to resolve this issue in definition, but rather use the term “institution” for both; this frees us from having to guess what each author had in mind, as most do not provide “up-front” definitions. The NI economist focuses on “the institution,” in both contexts, while the NC economist focuses on the individual, as argued later.

Philosophical and Methodological Differences

The NI economist generally has a philosophy best described as pragmatism (Gruchy, p. 126), wherein the concept that gives the most practical results determines its validity. This likely arises due to the view that the universe encompasses disorder, and conflict, as the natural order of things. Gruchy notes (p. 81):

The pragmatist has not a dualistic but instead a pluralistic approach to his interpretation of the social process. He abandons Marx’s class struggle, and puts in its place a struggle of many conflicting groups, which eventually resolve their disagreements not by overturning the existing social system but by reforming it.

Hence pragmatists are optimistic and activist in outlook. They are optimistic about the possibility of mankind solving its problems in an orderly, gradualistic and non-revolutionary manner. They are also activists whose enthusiasm for social and economic reform leads them to work for the creation of a more reasonable social and economic system.

Conflict is an inherent part of the economic process (Wilber and Harrison, p. 72). Bromley appears to agree, in that “...implicitly (an) institutionalist focuses analytical attention on power relationships among economic agent through the concept of entitlements” (p. 45). Power comes and is focused as a result of participation in the activities of a group.

The NC economist, on the other hand is best represented by the philosophical perspective of logical positivism (Gruchy, p. 126), wherein harmony in the universe is the rule. Man is viewed as operating in a cultural setting, over which he has little control or interest in controlling, but he can overcome and he does try to lower physical/biological constraints. Gruchy notes (p. 337), “...economic reality is found in a static pattern of logical relationships” as opposed to the evolving system conceived by the NI view. The world is characterized by order and rationality, and the best way to discover its nature is through human reasoning processes, in the NC view. As noted by Wilber and Harrison, “...in standard theory ... truth about reality lies in the logic of the theory” (p. 63), at least this was the view until the development of econometric techniques in the 1950's. Since then, most economists have become positivists, seeing empirical verification as key (Wilber and Harrison, p. 65). These economists basically believe there is appropriate methodology common to all sciences; in the NI view, however, there is thought to be different methodologies appropriate to each science, referred to as “holism” (Wilber and Harrison, p. 64). Friedman’s *Essays in Positive Economics* comes to mind as a work that espouses what has become to be known as the NC view; the emphasis is placed on the ability to

predict.

In the NI view, man is actively pursuing and creating the future, but under full recognition of the constraints put forward by the thermodynamic laws of nature. The NC view tries to deny the reality of the physical condition, such as in the argument that capital can be infinitely substituted (Dasgupta and Heal) for natural resources. It has been argued, however, the NI view is also naive with regard to the physical/biological system and the thermodynamic laws (Gowdy).

Wilber and Harrison summarize the methodological basis of the NI view with (p 71):

...institutionalism is holistic because it focuses on the pattern of relations among parts and the whole. It is systemic because it believes that those parts make up a coherent whole and can be understood only in terms of the whole. It is evolutionary because changes in the pattern of relations are seen as the very essence of social reality ... institutional economics has had an appreciation for the centrality of power and conflict in the economic process.

In addition there is a basic rejection of “economic rationality,” giving the other major area of difference. Dugger notes that NI economists construct pattern models and NC economists construct predictive models, both of them theoretical in nature (p. 900). The pattern model is sensitive to the institutional and cultural setting, and explains behavior only in that context; the predictive model uses assumptions and logical arguments, to deduce predictions (Dugger, p. 900). The NC model attempts to capture only the essence of the setting, while the NI model tends to be filled with the details of the process; Dugger (p. 902) notes: “Occam’s razor, in neoclassical hands, is used to cut away all the messy details (which institutionalists crave and neoclassicists abhor.”

NI economics is a holistic (Lower p. 99) concept, wherein systems analysis is appropriate

(Table 1). The focus is on the interactions among people (Gruchy, p. 287), more of an emphasis toward the “on-going social process” (Gordon, p. 3). The NC view is more conventional science in outlook: the analytical boundary must be drawn so tightly, and so narrowly, as to focus only on the parts, rather than the whole. This has manifested itself in the emphasis on the household and the firm, as opposed to the relationships within or among these presumed independent units. The NC view is reductionist in perspective; the NI view sees the economic system as an intricate part of the larger social system, and only a holistic approach is reasonable and feasible. So, relationships among individuals, and among economic entities are viewed as interdependent. As noted by Gruchy (p. 332), by the late 1800's, the scope of economics had been narrowed such that it became (and remains today) primarily “. . . study of the wealth getting and wealth using activities of individuals operating in the private market place.” This was in direct contrast to the earlier view of the classical political economy (Gruchy, p. 332). Also Gruchy (p. 333) argues that NI's generally refer to their broader view as political economy. Thus, NI economy is political economy. Lower (p. 87) has argued the neoclassicists “...exorcized political economy.” It appears the neoinstitutionalists are slowly but surely reversing the process.

The NC economist sees the ultimate need to predict, and thus seeks predictive evidence (Dugger, p. 906). The NI economist, in contrast, does not attempt an exact prediction of behavior, but rather from knowing in the early days of about the culture within IBM, we could predict that all those at work would wear a suit, but we could not necessarily predict its color (Dugger, p. 905). Thus, the emphasis of the NI economist is on the structure, on the detailed nature of the actual organization or the working rules (the institutional arrangement) (Dugger, p. 905). This perspective is apparent, for example, in Castle (1978); it is the structure of the

property rights that is important in understanding the behavior of the participants in the economic system (pp. 4-6). Castle also notes the need to look at case studies, and to use a broader based conception of economic analysis, “...(by supplementing the market failure literature with) economic analysis of particular public policies (case studies) and a modicum of political science and law (interdisciplinary with the social sciences)” (p. 2, comments in parenthesis by this author). Certainly this is the NI view.

The NI view is an interdisciplinary effort (Table 1), opening the economic analysis to questions of political power, social interchange, and other areas of social enquiry. In this sense, it also fits nicely with the emerging field of Ecological Economics, which also in an interdisciplinary effort. Also like NI, it moves forward by transdisciplinary accomplishments, oft times building new theories and approaches, and thus transforming older disciplines, or mixes of parts of older disciplines.

Differences in Psychology

NI economists generally reject the notion that individual behavior can be best explained from an individual’s unique biography (Averitt, p. 1043). Rather, individual behavior is the product of the institutions in which the individual participates, both affecting and being affected by institutional settings and changes. The NI view accepts behaviorism, which suggests man reacts in response to the institutional structures (the working rules, customs) as opposed to the NC view that the individual reacts on his own count, based on his own source of well developed individual preferences.

Professors at universities act like academics are “supposed to;” bureaucrats in natural resource agencies become institutionalized, and used to operating in a certain way, substituting

for rational economic man as conceived by the NC perspective. Institutions replace the individual as the “...fundamental social unit” (Averitt, p. 1043). The NI view suggests “...endogeneity and variability of preferences and the possibility of preference-shaping...” (Keller, et al., p. 942) by the institutional setting, as opposed to the traditional NC view that preferences are exogenous, and given. On the other hand, the neoclassical economists find “...social virtue in the outcome of myriad independent decisions, each based on individual self-interest” (Randall, 1978, p. 1). Dugger suggests the NC view assumes a psychology of subjectivism or methodological individualism as the foundation (p. 904).

The Continuum of Exclusive to Res Nullius Property Rights

The NC theory rests in the widespread existence of exclusive, non-attenuated private property rights. This is the only means by which self-interest can be manifested in reality, whereby individuals can seek to reach their own perceptions of “bliss,” through active exchange of property rights in active, highly competitive markets. The importance of non-attenuated property rights to the NC view has been highlighted by several (Bromley, 1978; Randall, 1978). While private property is basic and fundamental, this is not often made explicit in the writings of NC economists; Bromley noted, for example, that Baumol and Oates, in their book, never once mention property rights (Bromley, p. 44, footnote 1). This is more often than not the case with books and papers generated in the NC tradition.

The NI economists, especially those concerned with natural resource issues, find property rights central. Bromley has noted a social system is composed of three major components, namely the natural environment, the property relations or structural component, and the superstructure involving the “...belief system, values, art, religion and science” (p. 839). The

structural component is drawn out by the NI view for further examination. In this view, property relations become synonymous with institutions, and thus, institutional economics becomes focused on property, something taken as given by the NC view.

The NI view appears to be that there is a solution to natural resource allocation problems at some midpoint on the continuum. There will be massive market/institutional failure at the res nullius extreme, especially for the Samuelsonian public goods; the failure could be equally massive at the other extreme, with non-attenuated rights, characterized by substantive externalities. Some mixture, somewhere in-between, may be the “best” ...this is where institutional analysis and design comes to play. The NI analyst recognizes the vast middle ground, and seeks to find solutions to match. Yet, it does appear the NI analyst might also recommend the non-attenuated rights path, if analysis supports that route. The NC view, in contrast, always supports the private path, no matter what the analysis suggests, because only that ownership-control option is considered. Thus, the NI view is more encompassing, and appears to include the NC perspective on property relations. The NI economist might undertake a study of the intricacies of current property institutions, and how the evolution to this stage occurred, while the NC economist seems willing to accept a rather “...highly idealized concept of property” (Randall, p. 2). (Randall, 1978, p. 3)

Data and Data Sets, Variables and Parameters

The NC economist is generally rather comfortable with the use of econometric techniques that rely on the use of historical data sets to calculate parameters. Data is viewed much as it is by the physicist: there are ultimate truths to be discovered, and fixity in the system sufficient to justify a particular parameter estimate: Like in physics, a certain mass always

accelerates at the same rate. Thus, the economic system will always react in the same manner to certain stimuli, with a high degree of stability through time (Wilber and Harrison, p. 67).

The NI view is quite different. All economic data is purposive, value laden data, and as such must be viewed as dynamic and purposive in nature (Gruchy, pp. 288-289). The search for parameters is not especially meaningful, in this perspective.

The NC view is to discover the relationships among these stable data points, which measure the state of the system at some point in time. The NI emphasis is to describe and understand the underlying processes that give rise to particular parameter estimates. This does not mean the NI economist would not use econometric techniques: On the contrary, the view would be such parameter estimates are useful in explaining behavior over some very short time frame (days, weeks, maybe months), but that the process must be understood to really know how to interpret the results. The important time frame, as noted later, is extremely different in the two views.

Wants and Ends, Given or Derived

Wants and ends are the main focus in NI economic analysis. The focus is not on trying to determine the parameters of a recreational, travel cost equation but rather on the reasons for producing travel vans and recreational jeeps to influence the demand for the outdoor recreational experience. That is, the focus on the NI economist is on identifying the wants and ends, how did people come by these goals, how do these types of desires influence the manner in which issues are to be resolved, and what obstacles favor reaching these wants or ends? (Gruchy, p. 2189). In the NC view, in contrast, wants and ends are taken as given "...just tell us what you want and we (as economists) will help you find the best way to get it." The concentration is on how choices

are made, given the goals, as compared to the NI view that how the choices among ends was accomplished is equally important. The NI view will allow the analyst to examine the role of advertising, and the other activities of large U.S. corporations (institutions themselves), to affect the wants and need of citizens as regards the natural resource base. If consumers had been told, in the 1950's and early 1960's that household detergents were creating phosphorus loading problems in the nation's waters, the decisions may have been modified (as they were later in the decade, and into the early 1970's). The elasticity of demand for detergent is not the only important matter to study; the reason there is a demand curve at all is the focus of the NI economist.

Issues of “What-Ought-To-Be”

Economists having either perspective do not necessarily have to be advocates of particular solutions. However, NI economists appear as a group to be very concerned about the directions society is taking. In fact, one of the fathers of NI thinking, C. Ayres, offered the instrumental theory of value, as a substitute for the NC theory of value, wherein an action has economic value if it contributes to life-enhancement (Petr, p. 6). Price values are ceremonial in nature; instrumental values are real. The choice of an economic policy is simple: Select those that contribute to the life process. The NC theory of value is a utilitarian theory, and very different from the instrumental theory; the choice of economic policy using prices as the guideline is to support the status quo, of current claims to property arrangements (Bromley, 1978), thus reflecting the judgements of and lending further credence to those currently holding those claims. Randall (1978, p. 11) cites an example that makes the issue in contention quite clear, speaking of the NC view:

Income, wealth, and the distribution of power, rights, and entitlements are held constant. The needs of those with insufficient endowments are Pareto-irrelevant, and the failure to meet those needs casts no shadow on Pareto-efficiency. Slavery must have been efficient; if not, the slave could have mortgaged his expected lifetime earnings and bought his freedom (or, more precisely, some small residual thereof after the banker had been paid off).

Randall goes on to call this “presumptive efficiency analysis,” an excellent descriptor of one of the main points of concern in the NI view.

The NC economist also tends, whether knowingly or not, to advocate. This happens when the recommendation is to substitute the market mechanism for some other institutional arrangement, such as to bring price allocation and “rationality” into the resource use process (See, e.g., Anderson.) There seems to be a failure on the part of many NC analysts to recognize that prices are no more nor less than a normative reflection of currently held values, ethics, and wants by those having the income sufficient to express those goals in the market place. Thus, to recommend the use of a price mechanism (e.g., Gardner, in the case of water allocation in the western states) is to advocate that the set of values associated with those prices be used to replace the values currently used to accomplish the allocation process. Bromley (1982) has also noted that “Efficiency is a fickle master...” as a choice criterion for economists, because “...property arrangements determine what is efficient” and prices (and the level of efficiency) are “...simply an artifact of prevailing property arrangements, technical conditions, and the wealth position of buyers and sellers” (pp. 836-837).

Neither NI or NC analysts necessarily have to advocate. The analysis can be objective to the extent possible, given human beings are involved. In fact, most NI analysts would be open to doing the moral inquiry, and thus focusing on the fact content of values as well as the value content of facts, in a postmodernist look at science. The really important difference is that in the

NI view values must be determined and displayed, using information other than from markets. This would entail looking to the role of the courts and the legislature (Bromley, 1982), as well as the other organizations reflecting current institutional arrangements, in order to reveal such values. The NC economist must simply display the prices from well-functioning markets, or appropriately adjusted prices from something less than competitive markets. Then, participants in society, individuals and groups can choose as to which valuation system will lead to what is wanted.

Time Frame

The notion that man. creates his own future, and thus the importance of understanding values and wants, is fundamental in the NI view (Table 1). It also follows the NI perspective requires examining longer time frames. More specifically, the NI analyst relies on knowledge of conditions today, and the focus is on futures ranging from right now to the very end of mankind. In contrast, the NC approach is to rely heavily on the past, using “factual” data sets over past time periods, to analyze in the present and very near future (usually the next few months to few years, and certainly never more than 100 years from now). The NI future is usually much longer.

Technology, Institutions, and Change

The NC view is reasonably well known to even those with little formal training in economics: A great deal of complexity, and some might add, the more interesting part of the economic process, is usually relegated to *ceterus paribus*, an artificial description of reality at

best.³ Technology and institutions are assumed fixed and invariant through time, or handled as some parameter in a static equation (see, for e.g., a sample of the economic growth literature, as shown in Ferguson). In the NI view, technological change is absolutely necessary, and a precursor to all cultural and social change; in the NC view, technology is a constraint on activity (Table 1). The inherent conflict, due to technological change, and subsequent institutional change, is a major theme in institutional economics (Gowdy, p. 398).

Technology also serves to bring about resources in the “standard” NI view, with resources as a result essentially unlimited. This was the view of Ayres (Gowdy), but not that of Veblen who realized nature also contributed to value. There appears to be no strong consensus, one way or the other, as to whether there are physical limits on resource availability. Gowdy shows, however, that Marx fully recognized that capitalism would lead to destruction of the natural resource base if not controlled, and suggests that Veblen would have agreed. The NC view is similar to that of Ayres. Natural resources become, as a result of mans’ innovativeness, all a function of the creativity of the human mind, with no finite limit (Gowdy, p. 393). Georgescu-Reogen has argued persuasively otherwise, and it appears both NI and NC economists could benefit from an understanding of entropy as it relates to production processes.

The reality of current institutional forms to be addressed directly, rather than to be assumed away (Randall, 1978, p. 3). Institutions are not assumed, but rather are to become variables in the analysis.

³ Wilber and Harrison suggest this notion is used because of the NC economists’ inability to experiment (p. 68). In an attempt to emulate the approach of the physical scientist, where other things can indeed be held constant, the NC economist simply assumes they are constant, which in this author’s judgement is, at best, bordering on presumptuous!

Social Forces and Equilibrium

The NC view embraces market equilibrium, brought about by the harmony of non-conflicting interests, as the major force holding the economic system together. NI's view the set of cohesive social forces as being key, that any stability is due to the institutional arrangements being acceptable and useful and (again the pragmatism is apparent) giving the desired results. There is no such thing as equilibrium, per se, as defined by the NC view.

Social Cost

The NC view recognizes social costs as an aberration in the system, something to be handled through (generally) assigning property rights, or (possibly) using some remedial taxes and subsidies (Table 1); or, as ?? says it, social costs are a myth. The governmental role is to be kept to a minimum. By contrast, the NI view suggests there are pervasive social costs, especially as a capitalistic society matures, and that generally more and not less governmental involvement is needed as the maturation process continues. The modern capitalistic society has ceased to function in a self-adjusting mode (Adams, p. 3). The interesting question for the natural resource economist, especially those sharing the NC perspective, is to ask if a system that is not working should be brought to bear on natural resource management, use, and allocation issues, pulling such current management out of the realm of political economy.

Interventionist vs. Information Generator

Randall (1978, p. 3) suggests that one of the major differences between the early institutionalist economists and their classical colleagues was the interventionist-reformist approach to policy and institutional design. The responsible social scientist is to be "...not only an observer but also a reformer, identifying and consciously working for institutional changes

which would redress imbalances in power relationships and correct injustices,” in Randall’s reference to John R. Commons (p. 4).

It is generally the view of the NC economist, however, that reform is left to the reformer. The role of NC economics is in providing information appropriate to reaching the desired “bliss” point.

Reconciling the Neoclassical and Neoinstitutional Views

Gruchy (1972) appears to hold the view that NI economics subsumes all of NC economics, when he argues that price theory is a component and integral part of NI economics (pp. 322-325). Randall also espouses the view that NI economics internalized “...most of the theory and methodology of neoclassical economics” (1978, p. 8) and goes on to classify all economists NI as including “... almost anyone to the left of Chicago (the Chicago school)” (1978, p. 8). This view is depicted in Figure 1, Panel A, where the Venn diagram suggests the NI view totally encompasses the perspectives and methodology of NC economics.

Ranson is not as optimistic, where he argues that NI economics “... cannot be synthesized with the alternatives and must become the heart of a reconstructed economics,” as had also been suggested by Ayres (p. 1049). The two perceptions are based in different theories of value, and thus cannot be reconciled (Ranson, p. 1051). This is depicted in Figure 1, Panel C; one must choose between the areas of influence. Keller, et al., see it differently, with some hope for reconciliation of the two theories of value, between “enlightened” NC economists and NI economists. As they point out, there is some agreement on fundamental instrumental values – such as democratic participation (p. 951), suggesting there would be some overlap of the two circles, such as in Figure 1, Panel B.

NC economists sometimes argue that NC orthodoxy does adequately handle institutional problems (Mirowski, p. 593). In fact, it appears that most simply dismiss the NI views by appealing to complicated, “high (math) theory,” and noting that NI economists simply don’t understand (Mirowski, p. 594). However, Mirowski argues quite effectively that institutional analysis as practiced by neoclassical economists is lacking, because of the requirement of constrained optimization by atomistic individuals, which underlies the whole of the NC view. In any case, such analysis fits the interface.

Bromley (1982) suggests the two can be reconciled rather simply. The key is to recognize goals other than economic efficiency, make them explicit in analysis, and, as analysts, “... offer guidance in attaining those objectives” (p. 841). Efficiency calculations can be used, to help people reach multiple goals, such as in access to public lands, to consider a mix of public and private enterprises to provide a broad range of products and services. Efficiency concepts from the NC theory are still important; Bromley notes the need for an instrumental focus, which “... would concentrate on avoiding obvious inefficiencies but would pay considerable attention to the various individuals and groups affected by certain policies” (p. 842). It appears he is not ready to dispose of the NC concepts, but rather to temper them with the broader institutionalist perspective. Again, the overlapping area of Figure 1, Panel B becomes descriptive.

Given that institutional economics is no more nor no less than an “investigatory mode” (Wilber and Harrison, p. 73), the description of Panel B may not be an impossible task, but it still remains to be shown if it can be done. It is here that the greatest hope for reconciliation lies. There has been some advances here already; the notion of “social microeconomics” (Randall, 1975) and the property rights literature (see Furbotn and Pejovich for a review; also, see

Bromley, esp. 1978) reflect activity in the interface. Yet, there are efforts that rightfully can fit only one or the other of the categories.

In the interface, the tools of microeconomics are merged with the broader concepts of holistic (institutional) economics, to provide a happy marriage in approaches. The process is studied as a series of static equilibrium points through time, with standard microeconomic, NC concepts merged with notions of sociological attainment to reach desired ends.

There is a body of economic theory offered by the NC economists; the NI view may simply require using this body of theory in a slightly different manner. It seems tenable that both theories of value may be useful in different settings, for example, at minimum, the NC theory can aid understanding more about parts of the whole, looking at the process through time as a series of static mixes of decisions. This would still allow for the belief there really is a way to relate all the parts to some whole, and support the NI view that the total is greater than the sum of the parts. The process and understanding that process becomes the focus: the neoclassical theory can serve to help in that understanding.

Implications

We suspect there is a balance, a kind of symbiotic balancing of the neoclassical and neoinstitutional views of the world that can do a better job. Those choosing to aid the evolution of his mixture can provide a great service to the profession and, eventually, to improved natural resource decisions. This is served in part by those that function both as NI and NC economists (see, e.g., Castle, 1978, and Castle and Hoch, 1982, respectively; also, see Randall, 1975).

Institutional economists must, by necessity, be better social scientists, finding it comfortable to use concepts from the other social sciences, and to integrate economic concepts

with those of these other perspectives. This also implies the need for more interdisciplinary activity, more linkages with sociologists, political scientists, as necessary.

In some respects, the criticism of economics by those having a better understanding of physical/biological systems runs parallel with the criticisms by institutionalists; economics is lacking in reality – make it more real and descriptive of the real world, and it will be improved. The prescription has been the same: use more concepts and theories (e.g., incorporate the thermodynamic laws and models of human behavior from psychology/sociology), from the physical/biological systems, do “bioeconomic modeling,” and the net result will be better economic models. To reduce this criticism, the economist will have to form linkages with biologists, physicists, in another interdisciplinary effort.

Is institutional economics going to replace neoclassical economics? Can it serve to supplement the neoclassical approach? What is the appropriate mix of the two views? Some have argued there have been no results of consequence from application of the neoinstitutional approach just as vehemently as those who argue the neoclassical view is of little value: Ranson notes (in 1981) “... there is today neither a recognized or growing body of institutional principles nor a group of institutional economists influential in policy formation. In short, institutional economics is not a viable alternative to mainstream economics” (p. 521). We cannot judge, at this time, the validity of this perspective. We cannot say which is the “best way.” Maybe the best advice is “Above all, I insist on laissez-faire in our individual work as economists: Let each person do what appeals to him or her,” (Samuels, p. 1025). Are you drawn primarily to the neoinstitutional or the neoclassical view or to some mix? Only the individual can choose, and a conscious choice is highly desirable, lest one be accused of being inconsistent and something

less than rational, which may also be acceptable, depending on whether one is an institutionalist or a neoclassicist!

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Table 1. Neoinstitutional and neoclassical economic views compared.

Neoinstitutional (NI)	Neoclassical (NC)
Philosophical and Methodological Differences	
Philosophical pragmatism, with conflict a basic attribute of human activity. Humans create the future, bounded by thermodynamic laws.	Philosophical positivism, with a harmony of interests, within a setting of cultural determinism. Humans can overcome physical/biological constraints.
Describe the approach as holistic. The methodology is historical and statistical, in the attempt to describe actual conditions, and building theories based on that reality. Theory is modified through time as technologies and institutions evolve and change. Generally non-dogmatic.	Describe the approach as formalistic. The methodology is speculative, deduced from well specified premises and internally consistent. Theory is not modified, but is rigorously tested. If rejected, the data or procedures are improved. Generally dogmatic in nature.
The reality of the world is explicitly recognized and analyzed. The solution is a function of the problem setting.	An image is created of the world, and that image is analyzed and used as a criterion for judging real world performance. The solution is to form a market.
Economic system viewed as an integrated part of the social system.	Analytical boundaries drawn tightly around economic activities.
Inherently interdisciplinary. There are composite problems, inseparable in nature.	Single discipline view. There are economic problems, political problems, sociological problems, etc.
Differences in Psychology	
Behaviorism describes individual behavior, responding to the institutional/cultural setting. Focus is on the institution, as “working rules” or organizations.	Behavior explainable from knowledge of an individual’s unique biography. Focus is on individuals (households, firms) in the economic system.
Exclusive to Res Nullius Property Rights	
Focus on role of property rights in affecting action. Recognizes a role for common	Focus on non-attenuated, private property rights. Recognizes only a minimum role for

property institutions and markets.

collective/governmental action, mainly to facilitate rigorous competition in markets.

Data and Data Sets, Variables and Parameters

Analysts data set is “purposive” in nature, changing in a dynamic manner through time. Emphasis is on understanding the underlying processes at work, recognizing there are only variables.

Data is viewed as fixed and invariant through time. Effort is devoted to understanding the relationships among data points that measure the state of the system by estimating parameters, implicitly suggesting fixity; and stability.

Wants and Ends, Given or Derived

Concern is with human wants and ends. Recognize the role of production and availability in influencing those wants and ends. Concerned with how choices are made.

Wants and ends are taken as given. Concentrate on how choices are made among uses of scarce means, given these goals.

Supply and demand are inter-dependent. Supply is a function of demand.

Supply and demand are determined independently.

Issues of “What-Ought-To-Be”

Do not specify “what ought to be.” However, very concerned about the direction of society. Believe it important to point direction, to see if people really want these results. Suggest prices are normative in nature.

Do not specify “what ought to be.” However, use prices as objective measures of the direction society should take, reflecting the social preference.

Time Frames

Emphasis is on the future, now until the end of time, a view toward the future of H. sapiens as a species. Rely heavily on knowledge of the present, to deal with the future.

Emphasis is on the immediate future (at most 100 years). Rely heavily on past trends, to deal with the present and generally ignore the future.

Technology, Institutions, and Change

Technological change is a prime progenitor of conflict, in social and political

Technology is taken as given, Institutions are invariant. Political setting is stable. All

institutions, leading to change to resolve conflict. Science and technology are cultural imperatives, the main driving force in institutional change. Technology gives the potential for social evolution, and life enhancement. There exists the imperative of technology.

noneconomic features encompassed in “ceterus paribus.”

Developments in science and technology are the result of market forces and cultural change.

Social Forces and Equilibrium

Economic system held together by a system of cohesive social, political, and economic forces. Emphasis is on understanding these forces. Analysis of the system is focused on the process, in the attempt to determine “what’s going on here.”

Market equilibrating forces determine the cohesiveness of the economic system. The system is in equilibrium, or tending in that direction, so the processes of change need not be understood. Analysis is focused on summarizing the results of the process.

Interventionist, reformist attitude is common. Economists need to become involved, in insuring instrumental values are brought to bear in decision processes.

Economists role is primarily as information generator, on impacts of taking some path as opposed to some other, in calculating the opportunity costs of not being economically efficient.

Social Costs

Social costs are a normal part of “doing business.” Need collective action/ governmental involvement, and ever more such activity as the economic system matures.

Social costs are the exception to the rule. Stop governmental involvement in the economic system, except for private property right definition, national defense, and justice.

Interventionist vs. Information Generator

Instrumental values suggest there is a criterion for decision making, just as there is a “right tool” to complete some task. All that is needed is the necessary scientific knowledge of the options. The human imperative is to promote the life process. There are real values, in addition to price values, the latter of which are ceremonial in nature.

Values are reflected in the preferences of people now living, and those having sufficient income to express those values in the market place. Prices are revealed, and correct options are then selected based on those reflections of human values.

Democratic outlook on how people are to

Democratic outlook on how people are to

select life enhancing activities.

participate in markets, to attain any desired end.

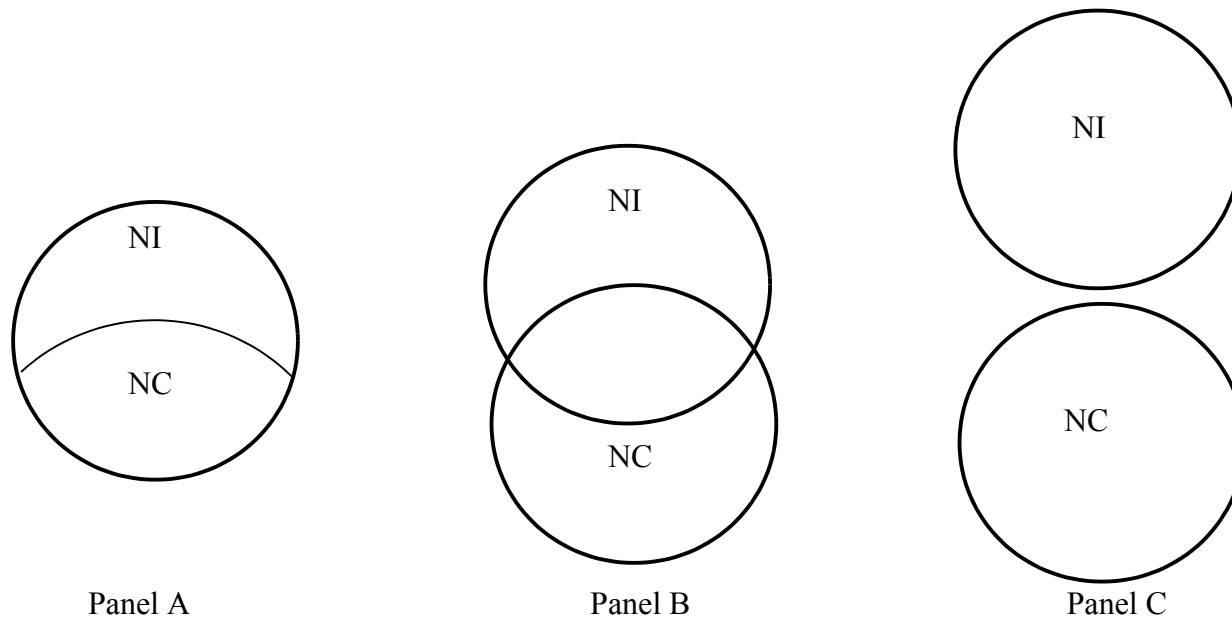


Figure 1. Mixes of area of emphasis and approach, neoinstitutional (NI) and neoclassical (NC) perspectives.