The meaning of market: comparing Austrian and Institutional economics

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Introduction

Economics have long concentrated almost exclusively on the analysis of purely competitive market structures, in which the institutional framework is exogenously determined and very weakly specified. But if it is more and more recognised that this model falls short of characterising market economies in which the price system operates with costs, and necessitates specific institutions, and in which firms are more than purely rhetorical devices, an alternative unified market economy theory is still missing. The main reason is that, outside the structuralist tradition, the market appears as a polysemic concept (Hodgson 1988) associated with various theoretical levels and dealing with extremely specific economic problems.

However, both the New Institutional Economics (Langlois 1986) and the Industrial Dynamics approaches (Carlsson 1989) aim at identifying some common themes which represent new directions in economic theory. The market theme constitutes of course one of the most discussed subjects, especially (not surprisingly) in an Austrian perspective. But if it is well known that the Austrian analysis of the market process represents (if we may paraphrase F.Hahn) a real 'base camp' for an alternative theory of the co-ordination of economic activities, a growing number of works are nowadays underlining the potential fruitful connections between Austrian and Institutional works on markets (O'Driscoll, Rizzo 1996) (Boettke, Prychitko 1994) (Wynarczyk 1992).

Our contribution aims precisely at revealing the terms of a confrontation between these two schools concerning the nature and the role of markets. In this perspective, we exhibit not only the common features, but also the possible complementarity of the market approaches contained in both theories.

The attempts to bring together two approaches traditionally considered as being antinomic are very recent. Though such difficult but fruitful confrontation have produced numerous publications[1], the question of the nature and the role of the market do not appear to have been systematically treated. After stressing the obstacles, the difficulties and the broad lines of a dialogue between two rival theories (Section 1), we will show that these two traditions converge in offering a processual market representation in an economic world characterised by strong uncertainty and historical influence (Section 2). The institutional element plays in this context a very ambiguous role: not only do institutions constitute an external framework (one that removes uncertainty) for market transactions (Commons 1934), they also appear to be internal to individual transactions, those ones leading to their adjustment and evolution. Following Lachmann (1994) the problem thus becomes to provide a joint analysis of the <u>permanency</u> and <u>flexibility</u> of institutions. Such analysis, based on a combination of elements stemming from both traditions[2] gives the opportunity to build an alternative framework which offers an approach to individual and group problem-solving activity within institutional-knowledge constraints (Section 3)[3].

Austrian and Old Institutional Economics: from rivalry to dialogue

Why lead a confrontation between Austrians and Institutionalists on market process? New Institutional Economics (NIE) (Langlois 1986) program intend to draw one's inspiration from old Austrian economics not from Old Institutional

Economics (OIE) regarded generally as theoretically inconsistent. Nevertheless, the contemporary debate on the evolutionary nature of the firm and market, and on economic as a process leads to a revival of the OIE way of analysing economics as an evolutionary science (Hodgson 1994; 1996). In some comparisons, OIE and NEI are seen as alternative or complementary programs (Hodgson 1989) (Langlois 1986; 1989) (Leathers 1989) (Rutherford 1989b; 1994) (Vanberg 1989). If we consider, after Langlois, that NIE is torn between a neo-classical and an Austrian approach, we can say that OIE is surely an alternative program to the neo-classical one, but it is not so clear when it comes to the Austrian approach.

It is the problematic confrontation of Austrian and Old Institutional Economics that we briefly discuss now.

A missed appointment

The story begins with a missed appointment, a large mutual ignorance and a misconception of the respective contributions of OIE and Austrians to economics.

It is a well-known episode in the history of economic thought that Veblen failed to de-homogenise Jevon's, Walras's and Menger's conceptions of economic behaviour when examining the marginalist preconception of human nature[4] (Langlois 1989). Veblen[5] was unaware of Menger's contribution to an economic theory of social institutions and ignored the famous distinction between pragmatic and organic institutions.

However, Veblen's works shared Menger's attacks of the German Historical School's argument that the historical and social diversity of institutions prohibits a theoretical generalisation. They also both stress the importance of ridding social theory of teleological elements of explanation. In distinguishing between pragmatic and organic institutions, Menger emphasises the necessity for social science to analyse how organic institutions evolved without a 'common will directed toward establishing them' (Menger 1963, p.146). Using the biological metaphor of the evolutionary framework of explanation along a Darwinian perspective, Veblen saw institutions as the product of 'blind cumulative causation'. But along the 'compositive method' of Menger's approach, the stress is put on individuals pursuing their own interests and on an invisible-hand explanation of the formation of complex social phenomena. For Veblen, there is a self-reinforcing causality between individuals and culture, neither of them being exclusive for social explanation[6].

The same way Veblen failed to take into account Menger's work, Hayek failed to take into account Veblen's.

Hayek's comments on Institutional economics in general are negative and grounded on very few arguments. According to him, Institutionalism is an American heir of German historicism and thus shares the same critique: they didn't produce a theory of institutions but a simple description, that is monographs without scientific economic analysis. While Hayek called for a study of evolutionary process of social phenomena similar to biological selection, he surprisingly didn't refer at all to Veblen's evolutionism, even as an opponent. As Leathers shows, Hayek has nevertheless developed a theory of cultural evolution grounded on an instinctual conception of human nature with numerous interesting parallels with Veblen's[7] (Leather 1990).

Neither Commons has taken into account the Austrian theory of institutions and evolution. Menger's works are evaluated in the line of their echoes with Marginalism or Methodenstreit. So despite some strong common elements in the Austrian and the OIE thought, founders didn't hold a dialogue[8].

Austrian and OIE as antithetic

The main reason called for, is that Austrian is a market focus tradition while OIE is an institutional focus tradition. As Samuels clearly states: ‘Austrians stress the markets as the allocative mechanism, Institutionalists stress the institutions and power structure which form and operate through the market as the real allocative mechanism’ (1989, p.59-60). Austrians didn’t ignore the existence of organisation and State regulation, they also significantly contributed to an evolutionary conception of the economic system. But they are mainly interested by abstracting the function and essence of the market as a system of order from the historical specificity of economic systems. By contrast, OIE do not see specific market structures as inherently ‘normal’ or ‘natural’ (Miller 1989) and do not agree that markets can be analysed qua market forces. The concept of ‘market’ is seen as a metaphor for the institutions, which form its structure and operate through it (Samuels 1995). They do not take the actual legal basis of capitalist system for granted, rather they questioned the formation and consequences of property rights. Moreover, according to OIE, government, legal foundations and politics inextricably intertwine with the operation of markets (Samuels 1989) and cannot be ‘exogeneised’.

A consequence is that while Austrians emphasise non-–deliberative decision making, OIE emphasises deliberative decision making or, put in Merger’s dichotomy, Austrians are organic institutions focused when Institutionalists are pragmatic institutions focused. For OIE, the twentieth century economic system cannot be understood with a pure market analysis. This anticipates the contemporary interest for a theoretical status of the firm, stressing the economic study on the ‘major institution of capitalism’, the business enterprise. Corporation cannot be reduced to the idea of the entrepreneur, because it results of the joint action of many groups. Veblen initiated the managerial conception of the firm and the corporate control problem that bankers, shareholders and managers interaction carry (Veblen 1904). For Commons, the collective action in going concerns is the main characteristic of actual economic system. He particularly insisted on the dual agency relationship (workers/employers) torn between co-operation and conflict and on the legal working rules supporting the system (Commons 1934). A corollary of this so called 'decision making' point of view is that Institutionalists consider analysis of power structure and of government agency in the formation and performance of markets to be necessary (Samuels 1995).

This great difference leads to a strong ideological opposition: Austrians are pro-market while Institutionalists think that market system needs social control and reform. According to the former, the scope of government activity must be limited in the defence of freedom (stated in political terms), or contractual liberty (stated in economics terms), and legislation must conform to the market order. Institutionalists emphasise that the free market economy is itself a system of social control, and that specific markets are what they are, and perform as they do, because institutions operate as a social control (Samuels 1995). They deny that markets are automatically beneficent and suggest that a democratic economic government can improve over existing arrangements. They do not see market and government as the two terms of an analytical opposition, but as Polanyi says, 'the road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism' (1994, p.141).

Austrian and Institutionalist are also seen as two strong and durable dissenting traditions in the light of economic methodology.

OIE is often misconceived as the American Historical School. Consequently, Austrians and OIE are seen as representative opponents in the Methodenstreit[9]. The first principle of the opposition is the duality: theory versus history. According to Austrians, the nature of the economic problem is the discovery and description of general laws that are present in any economic system. OIE denies the universality of economic laws that are considered, on the contrary, as embedded in institutional or historical circumstances[10]. A consequence of these opposite views is that Austrians are supposed to adopt an a priori deductive reasoning when Institutionalists are rather empiricists and pragmatists. The latter cannot accept the logical consistence of assumptions as a criteria of scientificity but rather that economic propositions are heuristics for social design (Miller 1989) (Gordon 1989) (Samuels 1989).

A last notable methodological opposition can be noticed: the explanatory variables in economic theory are individuals for the first, and institutions for the latter. The Austrian subjectivism is the foundation of its methodological individualism in contrast with the so-called Institutionalist's holism. According to Austrians, social structures are the unintentional result of the individuals self-seeking interests whereas for OIE institutions mould individual preferences and choices.

If many things seem to split the two traditions, Samuels and Boettke (respectively neo-Institutionalist and neo-Austrian) nevertheless defend the idea that there 'seemed to be significant common subject-matter and much parallel substantive content' (Samuels 1989, p.49).

The chief point of convergence is that they are outsiders vis-à-vis neo-classicism. As we shall explain in the next section, they both object to a-temporal equilibrium analysis. Economy is rather viewed as a dynamic process in an evolutionary perspective. They also contest the neo-classical conception of economic behaviour seen as passive and predetermined. They share emphasis on economics as a praxeological science in an uncertain environment, imperfect knowledge and radically indeterminate future. Time is a major issue in the necessary acquisition of knowledge governing human action, and institutions are a media for learning and for complex social interactions.

The market as an economic process: an ecumenical point of view

Presenting the intent of his 1986's book, The Market as an Economic Process, Lachmann explains:

> The central idea of this book is the market regarded as an economic process, that is, an ongoing process, impelled by the diversity of aims and resources and the divergence of expectations, ever changing in a world of unexpected change. It is my hope that this idea may also gain some sympathy from those whose inspiration flows from other than Austrian sources (1986, p.x)[11].

A few years later, authors such as Boettke and Prychitko (1994) echoed this will by stressing the relevance of exchanges with the Institutional work for the future trends of the Austrian theory of market processes. The question is then to determine the terms of such an exchange, which can only be done after singling out a minimum amount of features common to both approaches.

The processual nature of economic phenomena

The first feature, at the core of our project, relates to the dismissal of the notion of atemporal equilibrium that is ‘an equilibrium in which economic actions at a particular point in time are co-ordinated independent of what transpired just before that instant and what may transpire just after’ (Garrison 1986, p.89).

Such dismissal represents, as everyone knows, one of the most obvious features of the Austrian economics. By rejecting the concept of atemporal equilibrium, the Austrian school rejects the possibility of an objective knowledge of economic phenomena. The outcomes of the running of the market system cannot be objectively known, the adjustment process being likely to take on various forms which reflect the modes of interaction between individual plans. Markets are then best regarded as processes and the market economy is defined as ‘a network of markets in each of which, and between which, phenomena that may be described in terms of processes are occurring’ (Lachmann 1986, p.3).

The concept of process consists of two distinct elements (Ioannides 1992): (1) the principle of endogeneity which states that all economic processes are endogenously mobilised, and (2) time, underlining the fact that ‘the sequence of events becomes an issue of fundamental importance, as each event really constitutes the cause of the one succeeding it’ (ibid., p.9). Finally ‘the outcomes of market depend of what happens at their various stages and on the order in which events happen. This means in particular that antecedents will influence subsequent events in so far as acting men attribute significance to them and that therefore the order in which events happen matters’ (Lachmann 1986, p.4).

But the rejection of the state of equilibrium doesn't necessarily mean the rejection of the concept of equilibrium itself. First of all, because the idea of an individual equilibrium which implies that all aspects of an individual plan are compatible with each other is assumed, in the Austrian tradition, to hold a priori, even if the maintenance of such equilibrium over time requires that the data generated by the economy does not disrupt the agent's expectations. Second, because the traditional Austrian theory of market processes[12] does not rule out the idea of a trend towards a market equilibrium. On the contrary, it exists between the Lachmann's view of the fundamental indeterminateness of the market process and Mises's belief in the a priori nature of the tendency toward equilibrium, a wide range of positions, which are not really inconsistent with the notion of equilibrium[13]. The Hayekian and the Kirznerian stands are, in this point of view, representative of the place and the role assigned by this traditional Austrian theory to the notion of equilibrium. Whereas for Hayek (1937) the degree of indeterminateness of the market equilibrium viewed as the outcome of the interaction of several minds functioning independently from each other is removed by the empirical convergence of the expectations, the entrepreneur is the one who, according to Kirzner (1973; 1979; 1985; 1992), acts as the stabilising force and the adjustment of the market process towards equilibrium, by discovering and cancelling market errors, that is by exploiting profit opportunities.

Nowadays, the idea of a trend towards equilibrium is however widely criticised within the Austrian family itself. Following O'Driscoll and Rizzo it is possible to state that 'today many, if not all, Austrians accept the importance of disequilibrating tendencies in markets' (1996, p.xviii)[14]. Indeed, it appears more and more clearly, from an Austrian point of view, that 'the equilibrium metaphor has proven misleading and that the time has come to seek a less mechanical metaphor, one that does not trivialise the incessant change of market processes' (Boettke, Horwitz, Prychitko 1994, p.65). In particular, the question is to oppose to the Hayekian argument, which sees equilibrium as an empirical fact, the idea that if the equilibrating tendencies of markets are an empirical regularity, then human society must be tending towards a state of affairs without money, firms, or market institutions.

The important point here is that the recognition of the importance of disequilibrating forces goes together with another feature of modern Austrian economics, that is with a greater attention given to the prerequisites for equilibrating behaviour. As soon as the disequilibrating tendencies in markets are not simply the result of changes in the exogenous data, but arise from the source of equilibrating behaviour (the indeterminate response to perceived profit opportunities), it becomes necessary to discover the co-operating conditions that are needed to make equilibration more or less likely (O'Driscoll, Rizzo 1996, p.xxi). In other words, the problem is to determine the ordering principles which produce mutually reinforcing sets of expectations without denying that some expectations will be wrong (Boettke, Horwitz, Prychitko 1994)[15]. Such ordering principles will assume different forms in different markets, depending on what Lachmann (1986) calls the proximity of agents and their range of action.

The concept of pattern co-ordination proposed by O'Driscoll and Rizzo (1996) makes it possible to incorporate this dynamic character of the notion of market process, thus providing a solution to the problem of identifying ordering principles. Based on the distinction between typical and unique events[16], the pattern co-ordination analysis indicates that if the market is able to co-ordinate typical events and consequently to stabilise the economy, it is no more the case when the unique characteristics of human actions are taken into account. Indeed in this last case the market process becomes entirely indeterminate and the co-ordination of plans needs alternative co-ordination mechanisms. It is here important to notice that this analysis is general, insofar as it can deal with the numerous Austrian approaches of market process, the convergence towards equilibrium being a very particular occurrence in which identical events are repeated period after period.

If Institutionalists didn’t use the term “market process”, which is an Austrian copyright, they share the interest in the study of economic process. A distinctive characteristic of Institutional economics is its emphasis upon the concept of change. As Hamilton put:

The Institutionalist (...) considers change to be part of the economic process. Instead of viewing the economy as a fixed system periodically prodded into

> movement to a new point of non-motion, he holds that the economy is at all times undergoing a process of cumulative change, and that the study of economics is the study of process (Hamilton 1973, p.17).

Institutionalism thus rejects, along the Austrian approach, an atemporal equilibrium conception of the economy. 'The conception of the economy is of an evolving, open system in historical time, subject to processes of cumulative causation -instead of approaches to theorising that focus exclusively on mechanical equilibria' (Hodgson 1994, pp.68-69). With some notable differences, Veblen and Commons principal preoccupation was to analyse the process of change in the modern economy, and the neo-classical and marginalist conception of economic equilibrium was, according to them, inadequate for this theoretical purpose.

Veblen gave further grounds for developing an evolutionary economics, by stressing the processes of economic evolution and technological transformation. According to him, economics must break with its Newtonian preconceptions that make it no more than a 'taxonomic science', in order to become an evolutionary science (Veblen 1898). His idea is that the economic system is not a self-balancing mechanism, but a 'cumulatively unfolding process'. For him, 'Modern science is becoming substantially a theory of the process of consecutive change, realise to be self-continuing or self-propagating and to have no final term'[17]. The economic change and evolution process is captured by the Veblenian concept of cumulative causation: the prevailing way of thinking and acting are cumulatively reinforced and lead to locked-in phenomena. Hodgson interprets Veblen's view as a positive feedback analysis, in opposition to the neo-classical negative feedback conception (Hodgson 1994). In the latter the economic movement is stabilised and even broken, whereas in the first it is amplified and leads to a dynamic change with self-reinforcing property. These self-reinforcing attributes are a factor of continuity in this process of continuous change. For Veblen, the stability of the economic system depends on the coherence between the factors of continuity and the factors of change. But this form of equilibrium in the never-ending evolution can be disrupted when the factors of continuity fail to be coherent with the new circumstances. Hodgson (1994) thinks that Veblen’s evolutionism fits the modern biological theory better than the gradualist conception does. Particularly, the link between crisis and continual change in Veblen's explanation fits the ‘punctuated-equilibria’ (Eldredge, Gould 1977). There is something that is transmitted in the process of change and that constitutes the continuity and the identity of the economic system. But this form of equilibrium is not at all the same as in neo-classical economics.

In the same perspective, the central problem of economics is, according to Commons[18], a classical one: how can an order exist out of the conflict of individual interests due to scarcity? Commons departs himself from the explanation in terms of automatic harmonisation and unconscious co-operation generated by the price mechanism. The origin of order lies in what he called the working rules that specify what individuals can or cannot, must or must not, may or may not do in their transactions. ‘The working rules regulate behaviour in such fashion that potential conflicts of interest do not undermine the security of expectations without which individuals will not be willing to enter into transactions’ (Ramstad 1990, p.58). But the order grounded on the working rules of the society is neither natural nor immutable: it is an evolving order. The actual working rules always give rise to unanticipated consequences. Disputes and unregulated conflicts of interest are generated by new circumstances that lead to the rise of new working rules in a process of ‘artificial selection’ conducted by the authority figures that decide conflicts. Economic process is characterised by conflicting and co-operative transactions in many going concerns and by a permanent authoritative adjustment of the rules, aimed at maintaining the order. The equilibrium can be understood as the ‘workable mutuality’ and compromise brought by rules out of conflict. But it is, as for Veblen, an evolutionary perspective unsuitable with atemporal equilibrium question.

With a very different state of mind, Institutionalits and Austrians thus converge on some very important points of view about economics. Market process (enlarged to economic process for Institutionalists) cannot be understood with an atemporal equilibrium analytical apparatus. The principle of ‘endogeneity’ and that of ‘time’, that characterise the concept of process, are significant in the Institutionalist perspective: change is a cumulative process with reinforcing properties for Veblen, while for Commons change is the joint effect of unintended results of transactions and the resolution of the conflicts that emerge; the process is historical because change never produces a return to a previous state of affairs (positive feed back).

However, the evolutionary point of view doesn’t necessary mean the rejection of the concept of equilibrium. Equilibrium is a matter of convergence of the way of thinking and acting, that are transmitted by time and the current state of affairs in Veblen’s view, whereas it is the workable mutuality and reasonableness of actual rules that regulate potential conflicts in economic life according to Commons. For both, as for the Austrians, the meaning of equilibrium is a question of ordering principle and pattern of co-ordination, both of which harmonise and secure the agents' expectations. In other words, equilibrium then does not primarily depend on prices, but on expectations, information systems, and the interpretative frameworks which are used by economic agents (Loasby 1991). But this conception of equilibrium is far from the neo-classical perspective.

The creative character of human action

A second area of convergence for the Austrian and Institutional approaches, regarding the analysis of the operation of markets, lies in the fact that they both take into account the active behaviour of the economic agents[19]. This point is related to the recognition of the ignorance and uncertainty faced by markets agents as well as to the essential complexity of the market.

This is particularly blatant within the Austrian approach. Actually, one of the implications of considering the market as a spontaneous order is that no one has a particular knowledge of all relevant conditions on which economic action is based. The rejection of the price-taking behaviour and the conception of the market as a system in constant flux are based on the idea that the flow of information is the moving force of economic activity. Consequently, ignorance and uncertainty will surround most market decisions: ‘when a person is ignorant of particular influences in his economic environment and therefore uncertain about the success of possible undertakings, he will be alert to new information, and he will mull over the information he does have in formulating his decisions’ (High 1994, p.25).

The Austrian School's method of incorporating ignorance, uncertainty, and expectations into economic theory has been to stress the entrepreneurial element in human consciousness. Entrepreneurship theory indeed offers an answer to two important questions raised by the analysis of market processes (Ioannides 1992): (1) the question of describing the motives that mobilise the use of knowledge, and (2) the question of the (exact) way this behaviour is expressed in the market process. More precisely, it is possible to distinguish two types of answers which refer to two types of active behaviours, each one referring to the distinction previously pointed out between equilibrium market processes and indeterminate market processes (Boettke, Horwitz, Prychitko 1994).

The first type of behaviour is more particularly associated to Kirzner's work (1973; 1979; 1985; 1992). Indeed as it is well known, Kirzner defends the idea that the market economy opens up arbitrage possibilities because of the ignorance of individuals: finding a good that sells for different prices in the market is the most obvious example, but Kirzner believes that the discovery of factors of production that can be transformed into consumer goods can also be considered as an arbitrage if factor prices are lower than the price of the consumer good. The essence of the entrepreneurial behaviour is thus the discovery of profit opportunities. It is however important to notice that if such an entrepreneurial activity is a product of market disequilibrium, its character is by definition equilibrating since taking advantage of a profit opportunity is equivalent to cancelling it. The discovery-arbitrage behaviour represents a force that constantly pushes the market toward equilibrium.

This first kind of active behaviour is however considered as too poor, that is too mechanical, by the Austrian analyses which would rather adopt a Lachmannian reasoning[20]. Boettke, Horwitz and Prychitko thus explain that: 'Austrians have traditionally postulated a world of Robbinsian maximisers, and allowed the entrepreneur to seek arbitrage opportunities which equilibrate the market. Such an entrepreneur need only exercise alertness to profit opportunities. But entrepreneurship is also characterised by judgements about imagined future opportunities' (1994, p.65)[21]. The problem is hence to focus on the Lachmannian creative dimension of the entrepreneurial behaviour: 'the creative agent builds plans upon her imagination of the future[22] whereas the discoverer elaborates plans exclusively on the basis of the knowledge at her disposal' (Gloria 1996, p.8). However, when the role of judgement is added to alertness, expectations are granted full force and the satisfaction of some individuals' expectations can come only at the expense of the disappointment of others (Lachmann 1986)[23]. The consequence of this is that the market is now described as a process characterised by unexpected change and inconsistency of plans, incompatible with a systematic tendency toward equilibrium.

The conception of human action is a cornerstone of Institutional economics. The revision of the standard economic theory of behaviour was central for its understanding of social interactions in historical time. Institutionalists wanting to theorise foundations of economic order and its evolutionary process cannot be satisfied with the mainstream idea of rational choice, that takes individual behaviours as a given (Mitchell 1935). On the contrary, they focus on the formation of preferences (Hodgson 1985) in tight connection with the economic process itself. In contrast with the hedonist and optimising point of view, the Institutionalist understanding of human behaviour outlines, on the one hand the habits, routines, customs and rules that mould individual behaviour and constitute the larger agency of <u>ex ante</u> co-ordination of social relationships. On the other hand, individual action is cardinal in the process of change. Consequently, human nature is seen as an active and creative agency in the evolutionary course of the economic system.

Veblen underlined the paradox of the hedonistic and rationalist conception of the economic man: the individual is the first cause of economic phenomena but, at the same time, its psychology is exogenous and its choices are totally predetermined in the analysis. Human nature is, in this line, passive, inert and immutable[24]. Veblen opposes to the calculating, optimising agent of the neo-classical theory a less competent but less determined and more purposeful individual. The concept of habits plays a central role in the Institutionalist picture of the economic man[25]. ‘Habits are a form of non-reflexive behaviour that arises in repetitive situations; they are influences by prior activity and have self-sustaining qualities' (Hodgson 1996, p.6). Veblen was inspired by pragmatist philosophers and social scientists as James, Peirces and Dewey who considered that habits make it possible to solve the problems of uncertainty and complexity faced by human beings (Wallers 1988). But if habits repeat past practises in routines, they are not opposite to purposeful behaviour, free will and choice. Pragmatists say that habits are the primordial manifestation of human intelligence. Stated in contemporary terminology, they economise cognitive resources by reproduction of past actions in similar circumstances and permit a focal attention on new situations. According to Hodgson, modern economists (Becker for example) regard habits as an appendage of rational choice (Hodgson 1996). The pragmatist and Institutionalist perspective is the reverse: rational choice (economic calculus) is supported by habits, which authorise to concentrate on strategic factors whereas every day existence is driven by routinised rules of action.

Habits are the link between past and future. At the same time, they are a factor of stability of behaviours, and authorise adaptative, innovative and creative scope of action in an evolutionary perspective (that is to say in an evolving environment).

Commons also stresses the habitual and 'volitional' dimensions of human behaviour. He shares the pragmatist analysis of the human being, as a 'creative agency' whose intelligence is grounded on rules and habits. But the originality of his point of view lies in the unit of economic analysis he claims for (far before Williamson and with very different implications): the transaction instead of the individual. According to him, the individual cannot be considered as an 'object of nature', but as a part of an ongoing social process or, in his terminology, as participants in transactions. Transactions are joint actions (or collective actions) where individuals meet and where working rules control and expand individual action. Through collective action, working rules set limits to individual action and, at the same time, are ‘a liberation of individual action from coercition, duress, discrimination, or unfair competition, by means of restraints placed on other individuals’ (Commons 1934, p.17). A transaction is a situation of negotiation where rules are interpreted and adjusted and where preferences and wills are altered, where collective rules and individual choices are continually modified in the process of interaction (Bazzoli, Dutraive 1996).

This transactional point of view implies putting forward social interactions and collective patterns in the conception of human psychology that he called ‘negociational psychology’, that is a ‘social psychology’ because individuals are social beings and their actions are always transactions with others. Rules mould perceptions, representations and actions, and bring order out of conflicts and dependence between agents. But it is also a ‘volitional psychology’ which deals with human purposes and wills in a context of radical uncertainty. Commons considers the mind as ‘a creative agency looking toward the future and manipulating the external world and other people in view of expected consequences’ (Hodgson 1996, p.6). Will aims at exercising power over things and other humans, grounded on expectation of consequences in a context of uncertainty and complex social interactions. The fundamental ‘law of human nature’ is then the search of a security of expectations. Habits satisfy this fundamental need for reducing uncertainty and complexity. Commons calls ‘routines transactions’ activities, which do not imply conscious deliberation or attention. They support ‘strategic transactions’ focused on a ‘limiting factor’ in new situations wheres past rules or habits are inappropriate and need attention and deliberation.

Institutionalism thus defends the fact that individual action occurs in real time: present action is the result of expectations about the future and of a process of learning from past experience which transforms sense-data into information and knowledge and shapes individual choices in a context of radical uncertainty. In such context, perfect knowledge of the consequences of actions and of possible alternatives is impossible. The neo-classical link between rationality and optimisation is broken and replaced by a link between purposeful action and habitual behaviour. Habits are the condition of the creative activity of individual mind, which concentrates on innovation.

It now seems obvious that Austrians and Institutionalists are closely linked according to the importance given to human behaviour: economics as a praxeologic science, as Ludwig von Mises would state[26]. The agent is seen as a true actor (Langlois 1986) with an active and creative behaviour turned toward an uncertain, unpredictable and widely indeterminate future. It is now able, through market transactions, to exercise its intelligibility and economic understanding. This aptitude stems, in one case from an extension of individualism to subjectivism, and in the other from the integration of social components into the formulation of market plans by individuals. Thus, and although the analytical figures of such behaviours are specific, reflecting both the issues and theoretical foundations of two distinctive paradigms, both approaches understand behaviour as dealing with learning, adapting and acquiring the knowledge needed to face the complexity and uncertainty linked to economic action.

Towards an economics of time and ignorance

Finally, the Austrian and Institutional approaches converge in the exploration of the reality of the historical time, uncertainty, and ignorance in which market decisions and actions are taken. Doing so, they both contribute to the same dynamics of market mechanisms, which is the one at work in ‘the economics of time and ignorance’ (O'Driscoll, Rizzo 1996).

The emphasis placed by the two traditions on the disequilibrium processes and novelty cannot make do with an analysis which takes place in a logical time framework, with no genuine causality, a time span for which ‘at any moment (...), the past is determined just as much as the future’ (Robinson 1962, p.26). Both tradition ‘takes time seriously’ and accept that the properties of time, more precisely of a real time, characterise the sphere of economic activity.

The idea, shared by the two approaches, of an non-determined market process involves a sequential causality (Hicks 1979) which seeks to identify prior cause and subsequent effect, rather than to consider that everything affects everything else simultaneously (Setterfield 1997, p.69). The behaviours are therefore constrained by a strong history (David 1988), (the movement can only be forward, there is no scope for moving backwards through history) and the analysis is punctuated by the time of intention (Currie, Steedman 1990), that is a time that, while connecting the experience from the past and the expectations about the future to the objectives aimed through current decisions, represents the main driving force behind individual behaviour.

The notions of short and long period loose their meaning in such a framework; the Austrian and Institutionalist analysis of the market and economic processes thus contribute to the elaboration of a historical time framework: ‘In a historical model, causal relations have to be specified. Today is a break in time between an unknown future and an irrevocable past. What happens next will result from the interactions of the behaviour of human beings within the economy. Movement can only be forward’ (Robinson 1962, p.26).

Until now, the institutional dimension of the Austrian and Institutionalist approaches has merely been stressed, whereas this dimension is essential in the view of linking together the Austrian and Institutionalist standpoints within an ecumenical analysis of market processes which takes place in the economics of time and ignorance (O'Driscoll, Rizzo 1996). Indeed, when the future is unknowable, the expectations divergent and the discoordination forces as strong as the co-ordination ones, social institutions may enter the picture in order to align expectations and, doing so to be part of a theory of plan co-ordination.

In this line, Boettke (1989) Garrouste (1995), Rutherford (1989a) and Vanberg (1989) state that the Austrian and the Institutionalist conceptions of institutions are more complementary than conflicting. Boettke shows a methodological common ground between Veblen and the modern Austrian theory of institutions[27]. Garrouste and Vanberg, comparing respectively Veblen's and Menger's conceptions of institutions for the first, and Commons' and Menger's conception of evolution for the second, assert the complementarity thesis. According to Garrouste, the Austrian conception is about the institutional genesis, while Institutionalism is about institutional change. According to Vanberg, the Austrian conception is about spontaneous institutions, while Institutionalism is about designed institutions. Even the methodological dissension can be dislocated in a via media between individualistic and holistic points of view[28].

Our point of view, although contributing to the complementarity thesis, is different in the sense that it analyses the nature and the role of institutions in reference to the theoretical issue of the market process. Indeed, if the economic analysis of institutions constitutes an essential link in the Austrian project of building an alternative theory of markets, it is probably also the weakest one. The benefit of the confrontation is thus no longer, in our point of view, to underline the similarities but the complementarities in order to draw up a theory of institutions compatible with an (Austrian) market process analysis.

Market processes and institutional change: the <u>flexibility</u> *vs* <u>permanency</u> dilemma

It is unanimously recognised that institutions are, in an Austrian approach, of great influence to explain the market process[29]. In this respect, Lachmann's argument is representative:

> It would be wrong to think that a market economy, when faced with the problems just outlined, could, or in the ordinary course of events would, find no answer to them. History shows that whenever left sufficiently free from political interference to evolve its response to such challenges, the market economy has 'grown' the institutions necessary to deal with them. (Lachmann 1978, p.67).

Information, knowledge and co-ordination of individual plans: the institutions as points of orientation

The whole set of formulating concepts used to deal with social institutions, relies basically on the notion of <u>rule-following behaviour</u> (Langlois 1993, p.166): institutions are roughly regularities of behaviour understandable in terms of rules, norms and routines (Nelson, Winter 1982). According to Schotter, the definition of a social institution can be drawn from an Austrian perspective as 'a regularity in social behaviour that is agreed to by all members of society, specifies behaviour in specific recurrent situations and is either self-policed or policed by some external authority' (1981, p.11). Institutions are the means by which agents are able to gather sufficient information in order to co-operate.

More precisely, institutions convey knowledge through at least three different channels[30]. As 'congealed social knowledge', they aim at reducing a set of possible options, which amounts to saying that they reduce the agents' uncertainty related to each other's actions. This involves a better co-ordination of each individual plan according to environment specificities (O'Driscoll, Rizzo 1996). Moreover, institutions do not transmit knowledge itself, but rather the knowledge of how to make an effective use of skills that an individual will never possess. The idea is thus that, if people can rely on others in order to fulfil specific roles, then their expectations will be likely to be more co-ordinated. Finally, institutions transmit knowledge in the sense that the routine courses of action they embody are efficient adaptations to the environment[31].

In a word, institutions save knowledge and information (Lachmann 1970)[32]. Institutions then consist of general or enduring pieces of knowledge (O'Driscoll, Rizzo 1996, p.xxii) which provide 'points of orientation' likely to make actions and expectations relatively compatible (Lachmann 1970)[33]. Any practice that allows to reach individual goals spreads until it becomes an institution.

The peculiar status granted to the institution within the Austrian framework seems clearer now: since institutions are used to explain the transmission of information and knowledge, which is integrated in the formation and revision of plans, they represent the 'key link' that makes it possible to complete the reasoning chain of the Austrian theory about market processes. O'Driscoll and Rizzo indeed indicate that:

> Rules provide, as it were, save bounds for behaviour in a relatively unbounded world. Institutions are the social crystallisation of rule-following behaviour or, in other words, the overall pattern of many individuals following a similar rule (...). Thus, the circle is closed. Time and genuine uncertainty promote the following of rules and the development of institutions. The latter, in turn, serve to reduce, but not eliminate, the

> unboundness of the economic system by providing the stable patterns of interaction (1996, p.6).

The validity of the proposition that there is (or is not) a tendency toward equilibrium, thus depends critically on the nature of the institutional arrangements (Garrison 1986)[34]. Of course, the overall demonstration supposes that the knowledge spread by institutions is stabilising (in the sense that it constantly reaffirms the stability of the social framework) whereas the one dispersed by the price system is of a dynamic nature (in the sense that it leads individuals to a continuous revision of their plans) (Hayek 1945).

An endogenous explanation about the dynamics of institutions is however required in order to loop the loop. Indeed, if institutions act as signposts in a world of uncertainty, what we need is a theory of plan co-ordination, which integrates the fact that, not only do social institutions serve to align expectations, they may also deal successfully with the forces of change. It would otherwise be difficult to concede that the institutional element achieving to complete the analysis of the dynamic functioning of market processes will be the only one outside these dynamics. It is then a matter of assessing the Austrian representation in relation to its capacity for producing an analysis of the evolution of institutions within a market economy.

Permanency and flexibility of institutions: an Austrian dilemma

Such analysis must allow solving three types of problems (Lachmann 1970, pp.51-52). Firstly, there is the problem of institutional change and how to reconcile the idea of an institutional change with that of an institution as a ‘point of orientation’, which assumes its fixity. Secondly, the issue of the institutional order and its unity is formulated: if the complementarity of institutions builds the institutional order of a society, the purpose is then to identify the forces of integration as well as the circumstances under which these forces have stopped working. Finally, there is the question of the rise of new institutions that is to underline the requirements needed for new institutions to fit into the existing structure. Solving these three kinds of problems comes down to providing a solution to what we have agreed to call the permanency-flexibility dilemma: ‘If institutions are to remove uncertainty, they must be permanent. But if they are to be shaped by market forces they must be flexible. How, within the institutional order of modern market society, is this problem resolved?’ (Lachmann 1994, p.50).

Although there is no place for the evolution of institutions within Menger’s conception, the analysis of change is, on the contrary, an essential aspect of Hayek’s approach to institutions (Garrouste 1994; 1998). The latter holds in the idea mentioned above which imply that institutions embody efficient adaptation modes according to the environment. This means that institutions with inferior survival properties are removed by means of a selection mechanism. Besides the fact that in Hayek’s analysis an imprecision is found through the definition of the selection criterion (Garrouste 1994, p.863), as well as through the explanation of those survival properties (O’Driscoll, Rizzo 1996, p.40), such discussion of the dynamics of institutions cannot hold if the existing complementarity[35] of institutions within an institutional order (Lachmann 1970) is taken into consideration. The routine courses of action that comprise institutions are indeed not all independent. Some truly inferior routines must be maintained in order to permit the existence of those that are actually superior: ‘The implication of these considerations is that, in the absence of a clear conception of the nature of survival properties, we cannot know whether any given institution or course of action is the most adaptative’ (O’Driscoll, Rizzo 1996, p.40).

Lachmann's interpretation of the dynamics of institutions holds a distinctive place within the Austrian approach. Besides the fact that it claims to go back to a logic much more rooted in a Weberian discourse than in a Mengerian one, its main purpose consists in drawing the conditions for the attainment of both coherence and permanence of the institutional order, that is to deal with the accurate issue of complementarity[36].

The overall demonstration is based on the distinction made by the author between the 'legal norms' or 'designed institutions' which are 'the products of legislation and other manifestations of the "social will"' (Lachmann 1970, p.69) and the 'recurrent patterns of conduct which we call institutions' (ibid., p.75) or 'undesigned institutions'[37]. But, following Lachmann's logic, if, on the one hand, all institutions[38] do not take on the same status and function[39], they share, on the other hand, the flexibility property linked to the permanency of a whole. Indeed, the permanence of the institutional order as well as the legal one does not indeed involve the permanence of each part: 'Institutions rise and fall, they move and change. An institution may last a long time, but during this time assume new functions or discard old ones' (ibid., p.77-78). The raising matter is now how to make institutional change and structural permanence compatible, since it is not so much the change per se which brings up here problems but rather the unexpected one. Only the last type of change is likely to upset some plans in the course of actions. The issue is of course all the more important because the institutional change affects long-term plans. A much more harmful outcome from the occurrence of this kind of unpredictable change concerns the relationship between designed and undesigned institutions. Indeed, as institutions can only be indeed designed to face specific well-known situations 'the unexpected change of undesigned institutions may not merely jeopardise the coherence of the institutional structure as a whole, but in addition may obviate the very design of the designed institutions' (ibid., p.80).

The solution put forward by Lachmann in order to cope with this last kind of problem consists in setting up designed institutions which allow to integrate change without altering the institutional structure as a whole. The notion of interstices within the legal order represents here a key component for the institutional dynamics: 'the undesigned institutions which evolve gradually as the unintended and unforeseeable result of the pursuit of individual interests accumulate in the interstices of the legal order' (ibid., p.81). The function of those interstices is actually to lead to the accumulation of sediments coming from the evolution of undesigned institutions so that the coherence of the whole remains. Hence, according to Lachmann, if a society is fundamentally made of two types of institutions, the external ones which constitute the outer framework of the society and the internal ones, which gradually evolve as a result of market processes, the institutional dynamics however arise from the specificity of those interstices, shared by both kind of institutions.

Such understanding of the institutional dynamics therefore involves various comments[40]. The proposed pattern stems from the assumption that only the undesigned institutions evolve. But designed institutions also change. The analysis of the institutional dynamics then requires to consider two emerging issues: the first one is related to the structural change of designed institutions and the second is linked to the relationship existing between the changes in the legal order and the evolution of undesigned institutions. In other respects, it is possible that the coherence and permanence of the current social order would be jeopardised even without change in the legal system. It is particularly the case when the slow evolution of institutions extends beyond the interstices of an existing social and legal order, leading to what Lachmann has called as 'deformation of social space' (ibid., p.83). Although such relevant issues have substantial implications in formulating an overall representation based on the endogenous dynamics of institutions, they cannot be handle here. This stresses (if it was needed) all the difficulties faced by the Austrian theory in order to elaborate a theory concerned with the evolution of institutions.

The confrontation with the Institutionalist analysis is from this perspective decisive because it is precisely well known for being interested in the nature and the evolution of institutions.

OIE on the evolution of institutions

We want to stress here that even if the Lachmannian conception in terms of permanency-flexibility dilemma is formulated well enough as to embrace the institutional foundation of market process, the response he gave is not fully satisfying. The point is that the historicity of the economic process and the role of individuals in the evolution process are not adequately thought about. The Austrian conception is, in fact, prisoner of the image of a legal order (which is permanent outside the flexibility inherent to market process) in regard to market as an natural order that impedes it from a whole institutional dynamics analysis, considering the evolution of legal order itself, in relation with the global process of change. We think that the old institutional school can bring elements to complete the unfulfilled Lachmannian framework.

The first point is that there is an originality of the general Institutionalist conception of institutions that cannot be reduced to the ‘external’ co-ordination function of institutions, even if some functional properties that Institutionalists associate with institutions fit the Austrian’s conception: in a very uncertain environment, individuals with bounded rationality need a pattern of co-ordination; rules bring knowledge and information for plans and organise actions out of complexity. Veblen called ‘Institution’ the ‘habits of thought common to the generality of men’ (1919, p.239) when Commons definition was ‘collective action in control, liberation and expansion of individual action’ (Commons 1934, p.73). Even if they seem very different, theses quotations point out two important topics: action, choice and preference are not data but are moulded by institutional settings; individual action cannot be isolated from a process of social interaction. But this fundamental influence of institutions on human value, preferences and modality of choice is not a deterministic one. If institutional rules and norms mould individual actions and interactions, they never totally determine the result of the economic and social process[41]. As we have already said, the individual is a creative agency of change at any level of the institutional framework. The general principle of evolutionary dynamics results from the interaction between institutional rules and principles and human agency, that leads to an incremental and reinforcing change in the structures and in the pattern of preferences and behaviours.

The second point is that the process is not always an efficient one. The Institutionalist representation of evolution looks like the Hayekian ‘smooth adaptation mechanism’, but with notable differences. The incremental evolution of institutions and human behaviours can lead to crisis, disruption, bifurcation and finally to real innovation. The criteria of selection in the Austrian understanding of evolution is in accordance with the idea of efficiency of practices vis-à-vis the environment, that is the behaviour of the most successful group is imitated and developed. There is no such reference to efficiency in the Institutional standpoint, which stresses that institutions do not necessarily serve the functional needs of the society, but ‘vested interests’. Veblen points out the existence of long-lived ‘imbecile institutions’, ‘archaic’ and ‘ceremonial’ habits of thought that restrict the potential benefits of the spread of production and of technological innovations. Abandoning a reasoning in terms of efficiency, OIE is thus more likely to release the permanency-flexibility dilemma.

The third point, adopting Veblen's reasoning, is that the problem of evolution is less a question of adaptation according to a criterion of efficiency, than a problem of coherence out of the institutional diversity in a general institutional framework, and a problem of synchronisation in the historical time. This idea is closely akin to Lachmann's questioning about the genesis of novelty inside a stable institutional framework or, put in theoretical terms, the permanency versus flexibility dilemma. Yet, it departs from it in some fundamental points including, on the one hand, the historicity and the path-dependence magnitude of the evolutionary process and, on the other hand, the idea that the economic process is a whole process of change, and not only a change of 'internal institutions'. The idea of Veblen is that human beings are the result of a combination of fundamental instincts[42] selected by the institutional configuration. Institutional patterns remove internal variation and stabilise individual behaviour. As Hodgson showed, in a self-reinforcing mechanism, institutions become locked in relatively stable and constrained paths of development (1994). In this line, there is a relative invariance and self-reinforcing character of institutions. For Veblen, this process can lead to an incompatibility or incoherence between predominant institutional principles and the material or technological state of the art. The instinctual human nature is an element of an endogenous tendency of evolution, because human action can generate novelty, diversity in the practices and new routines, particularly in the technological area. In contrast, the stability of the institutional principle (the institutional lag) can bring conflict with the actual conditions of economic life. In other words, a disruption can emerge in the evolutionary process because of a temporal gap between, on the one hand, past and self enforcing routines and, on the other hand, new habits of thought stemming from the human creativity. 'Institutional development and change in these terms can be linked to strata shifting slowly at different rates, but occasionally causing seismic disturbance and discontinuities' (Hodgson 1994, p.65).

The last point concerns the articulation between designed and undesigned aspects of institutional evolution. Precisely, Lachmann links together the stability property of the legal order (seen as a designed institution) and the dynamic property of market process (seen as undesigned) with his idea of interstice between internal and external institutions (see supra). Underlying the legal order of the market, Lachmann shares Commons' interest in The legal foundation of capitalism (1924) and the importance of the 'legal/economic nexus'[43] in the understanding of the logic of economic transactions, but Commons' conception is a more evolutionary analysis, that includes the change in legal order itself. According to Commons, evolution is a 'volitional process' submitted to an 'artificial selection' (Ramstad 1990; 1994). This perspective is in radical opposition with the natural selection metaphor of economic evolution in as much as it relates to what is usually taken as undesigned institutions, like money. Commons gave a subtle demonstration that economic order itself is an artefact[44]. But this conception is not as deterministic as a superficial evaluation could conclude, because Institutional Economics do not devote a crude holistic viewpoint but a combination of institutional causation and individual causation for understanding social process. Working rules delimit and support the transactions but transactions give rise to unanticipated consequences, new opportunities and conflict about the share of 'burdens and benefits' of the wealth created by collective action. The economic process includes a never ending process of making new rules regulating conflicts of interests, because a procedural resolution of conflicts is a necessary support for transactions and order. This is an 'artificial selection' because the choice (if not the emergence) of new rules is the fact of, and the reflect of the purpose of authoritative figures. 'Commons understood the economic process to involve a circular causation in which the individual will and its objective expression, a choice, is at one consequence and cause of working rules' (Ramstad 1990, p.79).

The point is that legal order is not only, as in Lachmann's conception, an institutional matrix for market forces (that eventually impedes market forces from efficiency) or in Lachmann's terms, an external institution that evolves independently from economic process[45] and whose function is to support stability of fundamental principles of market and to correct markets failures (uncertainty and information problems). Indeed in Commons' analysis, the legal order is (so to speak) inside each transaction[46] (intrinsically defined and ordered by working rules) and evolves in close articulation with the economic process itself. Evolution is an incremental process of change of rules and behaviours, and the diversity of practices is filtered by an 'artificial selection' of new rules promoted by authority figures. One consequence is that there is no such strict distinction between designed and undesigned institutions. All forms, at any level of the hierarchy of the institutional framework, are in part designed and in part spontaneously produced.

In this line, the figure of the market is not that of a natural order but that of a historical and social product of evolution, that is a set of rules and arrangements purposefully selected out of conflicts.

The Austrian conception of institutional evolution fails to undertake the very nature of market process as an evolving set of institutions, because the market is understood as an immutable order (in its essence if not in its form) independent of the 'volitional' process of selection of rules that incarnates it. Austrians not only refuse the idea of the authoritative choice at work in the market process (understood as a corruption of the well functioning of the system), but so doing, they underestimate the real potential creativity of individuals. The market process is thus, in fine, an abstract constituting principle of people's interactions, not an historical product of the creative agency, because people's actions never influence the form and principles of the market system. In contrast, Institutional Economics understand the market system as a never ending process of change in practices and rules; in this line, the market is never always the same, but a changing institutional configuration. The Austrian analysis explains the permanency in reference to the naturality of catallactic principles but in the same time this reference prevents it from a satisfying evolutionary conception. The flexibility of the market process is not evolution. In the reverse, the Institutionalist analysis is able to loop the loop Lachmann's reasoning about the institutional dynamic. If institutions provide 'points of orientation' and 'patterns of co-ordination' for transactions, transactions induce a permanent and cumulative process of change in institutions themselves, and at the highest level of the institutional structure, create an evolution of the legal order itself. The general order is, in this line, not set up as an abstract and permanent principle, but as a real product of human will in conflict/co-operation, and as a result of a cumulative and historical process.

Conclusion

The purpose of this chapter was to lay out the broad lines of a positive confrontation between the Austrian analysis and the Institutionalist one, founded on the market co-ordination theme. Such an approach, though being a priori heretical is justified by, on the one hand, the characteristics shared by both theoretical traditions, and on the other by the existence of complementarity, which founds a representation of market mechanisms in terms of process. The analysis thus obtained, which grants a crucial place to the dynamics of institutions, builds a bridge between two traditions which have more to exchange than is usually thought, particularly in the perspective of the elaboration of an alternative theory of the market inside which time matters.

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[1] In addition to the Symposium on Austrian and Institutional Economics (Samuels 1989), see Garrouste (1995), Wynarczyk (1992), Leathers (1990; 1989), Vanberg (1989), Gunning (1986).

[2] The fact that both Austrian and Institutional economics are internally heterogeneous makes comparisons between these two research traditions difficult, since one has to identify 'representative' members for both. Our purpose is not to be exhaustive but to highlight some similarities and possible complementarities between the two schools regarding the notion of market process.

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[3] This project has been formulated by Wynarczyk (1992).

[4] Jaffé (1976) has argued that Veblen's critique of the economic man fits Jevon's and Walras's theory better than Menger's.

[5] Veblen also discussed Böhm Bawerk's theory of capital, but we do not examine here this analytical link between the Austrian and Institutional thoughts. See Veblen (1891-1892).

[6] According to Garrouste, these approaches are more complementary than usually considered because Menger focuses on the institutional genesis, while Veblen focuses on institutional change (Garrouste 1995).

[7] Leather's concluding statement is that 'a close inspection, (...) reveals substantial differences in their concepts of instincts. Veblen developed a more general theory of the types of instincts and how instinctive proclivities interact with acquired habits to shape human behaviour. Hayek's instincts of solidarity and altruism resemble in some respects Veblen's parental bent, but there are no hayekian counterparts to the instincts of workmanship and idle curiosity' (Leather 1990, p.175).

[8] Mitchell wrote the introduction to an English version of Wieser's Social Economics and Hayek studied with him in the early twenties.

[9] We set out general principles for the methodological opposition between the two traditions that are inevitably overdone. A close examination, which is not the main object of this contribution, would show a great methodological diversity within both traditions.

[10] Neither Veblen, nor Commons or even Mitchell defends an a-theoretical conception of economic science. Their works are rather attempts to fit the theory with the actual economic characteristics, as they considered that the classical and neo-classical theories fitted the eighteenth's century capitalist economic system, not the actual system.

[11] We underline.

[12] The 'traditional' Austrian theory of the market process refers to the contributions of Hayek, Mises, Kirzner and Lachmann.

[13] For an analysis of how Austrians have used the equilibrium construct, see Fink and Cowen (1985).

[14] Of course, Kirzner does not share this position.

[15] Let us remind that 'The concept of order (...) has the advantage that we can meaningfully speak about an order being approached to various degrees, and that order can be preserved throughout a process of change. While an economic equilibrium never really exists, there is some justifications for asserting that the kind of order of which our theory describes an ideal type, is approached in a high degree' (Hayek 1978, p.184).

[16] Typical events are events, which an observer perceives as being repeated regularly, as long as the process itself is being repeated. Unique events are the ones that occur only once and are thus time dependent; they can never be discovered (O'Driscoll, Rizzo 1996).

[17] Quoted by Hodgson (1994, p.66).

[18] It is not our purpose to expose the very dense theoretical system of Commons, based on very interesting concepts as transaction, going concern, working rules, sovereignty, negociational psychology, institutionalised mind, reasonable value.... For a more complete exposition, see Ramstad (1990). Our purpose is just to connect Commons' approach to the question of equilibrium.

[19] It is here impossible to pass over the Institutionalist criticism of the subjectivist approach. The main target of this criticism is the rational and hedonistic character of the 'Austrian subjectivist economic man'. However, it is possible to demonstrate, considering the works of Perlman (1986), Boettke (1989) and Wynarczyk (1992), that the praxeologic approach not only dismissed the alleged rationality of the Benthamite calculus but also the hedonism which motivated it.

[20] That is, a reasoning which tries to take into account the subjective character of both anticipations and knowledge (Lachmann 1976).

[21] We underline.

[22] 'Successive stages of market processes thus reflect nothing so much as successive modes of re-orientation as the mind of the actors fits means to ends in ever new forms prompted by new forms of knowledge and imagination' (Lachmann 1986, p.5).

[23] 'In a competitive game there are winners and losers. By the same token, competitive market forces will cause discoordination as well as co-ordination of agents' plans. In fact they cannot do the latter without doing the former' (Lachmann 1986, p.5).

[24] We cannot resist the pleasure to quote Veblen's famous description of the so-called economic man: 'The hedonistic conception of man is that of a lighting calculator of pleasures and pains, who occilates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum, in stable equilibrium except for the buffets of impinging forces that displace him in one direction or another. Self-poised in elemental space, he spins symmetrically about his own spiritual axis until the parallelogram of forces bears down upon him, where-upon he follows the line of the resultant. When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before' (Veblen 1898, pp. 389-90).

[25] Veblen's idea of human behaviour is also grounded on a few fundamental instincts, but we do not develop this aspect here.

[26] Let us remind that 'praxeology rests on the fundamental axiom that individual human beings act, that is, on the primordial fact that individuals engage in conscious actions toward chosen goals. This concept of action contrasts to purely reflexive, or knee-jerk, behaviour, which is not directed toward goals' (Rothbard 1976, p.19).

[27] 'The Austrian criticism of neo-classical economics is firmly ground in a Veblenian appreciation of institutional and historical factors in economics' (Boettke 1989, p.74).

[28] According to Rutherford, mentioning Agassi's institutional individualism (1987), 'At least a significant part of work of Institutionalists and Austrians is not as methodologically incompatible as is usually thought' (1989a, p.164).

[29] See for example the new introduction of the second edition of O'Driscoll and Rizzo's book (1996, p.xxii); see also Garrouste (1995; 1994) and the contributions in Boettke and Prychitko (eds) (1994). It is the very same motive which induces Langlois to state that 'Menger has perhaps more claim to be the patron saint of the New Institutional Economics than has any of the original Institutionalists' (Langlois 1986, p.5).

[30] Here, we still consider an overall Austrian point of view.

[31] This last conception (from Hayek) is examined below.

[32] The role of institutions in reducing information costs is outlined by the game-theory approach through such notions as 'convention' (co-ordination game) or 'norm' (prisoners' dilemma game) (Schotter 1994).

[33] 'An institution provides means of orientation to a large number of actors. It enables them to co-ordinate actions by means of orientation to a common signpost' (Lachmann 1970, p.45). The so-called concept of 'orientation points' expresses the idea of a decreasing instead of an elimination of uncertainty (Lachmann 1994).

[34] Indeed 'so long as the arrangements are such that expectations consistent with underlying economic realities are rewarded and expectations consistent with those realities are penalised, the tendency can be expected to prevail' (Garrison 1986, p.97).

[35] O'Driscoll and Rizzo use the term <u>indivisibility</u> (1996).

[36] We do not however introduce the analysis about coherence.

[37] One may recognise here the Mengerian distinction between pragmatic and organic institutions.

[38] In the broad sense of the term, that is, taking into account both designed and undesigned institutions.

[39] Some are more fundamental than others in the sense that they are basic institutions of the market society: 'They must exist before there can be markets which function smoothly' (Lachmann 1994, p.50).

[40] Lachmann himself has first suggested these remarks.

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[41] Lachmann and more generally Austrian Economics take these arguments into account, but they appear to be marginal when they constitute the heart of the Institutional analysis.

[42] According to Veblen, the idea of instinct justifies the selection of institutionalised behaviours out of the diversity of conducts grounded on instinctual proclivity (workmanship instinct, parental bent, idle curiosity, and predatory instinct). This idea of instinctual proclivity in human behaviour is not inconsistent with an evolutionary conception of human being; it is a dialectical vision of human beings, between stability and evolution.

[43] For Commons, the relations that economics study is not the so-called exchange of goods, but a transfer of property rights: 'Transactions, as thus defined, are not the exchange of commodities, in the physical sense of delivery, they are the alienation and acquisition, between individuals, of the rights of future ownership of physical things, as determined by the collective working rules of society. The transfer of these rights must therefore be negotiated between the parties concerned, according to the working rules of the society, before labour can produce, or consumers can consume, or commodities be physically delivered to other persons' (1934, p.58). This conception justifies that legal and economic perspectives cannot be analytically separated.

[44] For a very detailed exposition see Ramstad (1990).

[45] Lachmann embraces the 'public choice' idea that laws are made by judges in a political process in accordance with a pure methodological individualism (Lachmann 1979).

[46] According to Commons, a transaction always involves a minimum of five protagonists: a seller and a buyer, an alternative seller and an alternative buyer, and the legal authorities that embody the process of arbitrating conflicts with rules. 'Consequently, if transactions are to go on peaceably without resort to violence between the parties there must always have been a fifth party to the transaction, namely, a judge, priest, chieftain, paterfamilias, arbitrator, foreman, superintendent, general manager, who would be able to decide and settle the dispute, with the aid of the combined power of the group to which the five parties belonged' (Commons 1924, p.67).